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Supreme Court, U.S.
FILED
MAY 14 1987
JOSEPH F. SPANIOL, JR.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

No. .

In re:

BERRY ESTATES, INC.,

Debtor.

BERRY ESTATES, INC., Petitioner,

v.

HON. EDWARD REGAN, COMPTROLLER
OF THE STATE OF NEW YORK

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND JUDICIAL CIRCUIT

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161 pp

QUESTIONS PRESENTED

1. Whether a state authority with the power to enforce non-punitive state court escrow orders can circumvent the Bankruptcy Code provisions which determine: a) the extent of property of a bankruptcy estate; b) the rights of a prepetition custodian of the debtor's property; and c) what occurs when property is unclaimed. In the case at bar the state authority filed a proof of claim on behalf of creditors who, after due and proper notice, failed to file a proof of claim. The end result of such a filing being, effectively, escheat to the state's treasury.

2. Whether an escrow agent to a debtor who filed for relief under Chapter 11 of the bankruptcy code can be enriched by being permitted to retain monies when the possible beneficiaries of the escrowed

funds have not timely filed claims and are nowhere to be found.

3. Whether a governmental authority, or any individual, can successfully prosecute proofs of claim on behalf of claimants who have a private right of action, and who never authorized the filing of a proof of claim on their

behalf, and whose whereabouts are unknown to the entity which files the proofs of claim.

4. Whether a bankruptcy court may, sua sponte, extend the bar date for which certain claimants may file claims, when: a) the order was made within an unrelated proceeding concerning an unrelated claimant; b) the Bar Date had long since passed; and c) no party sought such relief.

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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1986

BERRY ESTATES, INC.*, Petitioner,

v.

HON. EDWARD REGAN, COMPTROLLER OF THE STATE OF NEW YORK,**

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND JUDICIAL CIRCUIT

---

* Blueberry Hill Management Corp. is an affiliate corporation of the Petitioner.

** The Honorable Edward Regan, Comptroller of the State of New York is the only party to this action other than the Petitioner. In the official caption at the United States Court of Appeals for the Second Judicial Circuit, it may appear as if there are three parties. However, "State of New York" and the "Hon. Edward Regan, Comptroller of the State of New York" are one and the same.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Berry Estates, Inc., the petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Judicial Circuit entered in the above-entitled case on February 19, 1987.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Judicial Circuit is reported at 812 F.2d 67 and is printed in Appendix A hereto, infra, page 59. The opinion of the District Court is unreported and is printed in Appendix A hereto, infra, page 70. The Opinion of the Bankruptcy Court is reported at 49 B.R. 1002 (Bktcy.S.D.N.Y.) and is printed in Appendix A hereto, infra, page 90. The order of the Bankruptcy Court is printed in Appendix A hereto, infra, page 113.

JURISDICTION

The judgment of the Court of Appeals was entered on February 19, 1987. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

This case arises out of Title 11 of the United States Code.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the issue of federal supremacy (United States Constitution - Article VI, Clause 2) as provided to bankruptcy matters by the United States Constitution, Article I, Section 8, Clause 4.

> United States Constitution - Article VI, Clause 2: This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.
>
> United States Constitution Article I, Section 8, Clause 4: To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States.

This case further involves the following federal statutes:

Title 11 U.S.C.:

> §347(a) Ninety days after the final distribution under section 726, 1226 or 1326 of this title in a case under chapter 7, 12, or 13 of this title, as the case may be, the trustee shall stop payment on any check remaining unpaid, and any remaining property of the estate shall be paid into the court and disposed of under chapter 129 of title 28.
>
> (b) Any security, money, or other property remaining unclaimed at the expiration of the time allowed in a case under chapter 9, 11, or 12 of this title for the presentation of a security or the performance of any other act as a condition to participation in the distribution under any plan confirmed under section 943(b), 1129, 1173, or 1225 of this title, as the case may be, becomes the property of the debtor or of the entity acquiring the assets of the debtor under the plan, as the case may be.

§362(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investors Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of-

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the cause under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

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(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay-

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

(2) under subsection (a) of this section, of the collection of alimony, maintenance, or support from property that is not property of the estate;

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(3) under subsection (a) of this section, of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(6) under subsection (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761(4) of this title, forward contracts, or securities contracts, as defined in section 741(7) of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title,

arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by or due from such commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency to margin, guarantee, secure, or settle commodity contracts, forward contracts, or securities contracts;

(7) under subsection (a) of this section, of the setoff by a repo participant, of any mutual debt and claim under or in connection with repurchase agreements that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of repurchase agreements against cash, securities, or other property held by or due from such repo participant to margin, guarantee, secure or settle repurchase agreements;

(8) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units;

(9) under subsection (a) of this section, of the issuance to the debtor by a governmental unit of a notice of tax deficiency;

(10) under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property, or

(11) under subsection (a) of this section, of the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument;

(12) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Transportation under the Ship Mortgage Act, 1920, (46 App. U.S.C. 911 et seq.) (including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage, or a security interest in or relating to a vessel or vessel under construction, held by the Secretary of Transportation under section 207 or title XI of the Merchant Marine Act, 1936 (46 App. U.S.C. 1117 and 1271 et seq.,

respectively), or under applicable State law; or

(13) under subsection (a) of this section, after the date which is 90 days after the filing of such petition, of the commencement or continuation, and conclusion to the entry of final judgment, of an action which involves a debtor subject to reorganization pursuant to chapter 11 of this title and which was brought by the Secretary of Commerce under the Ship Mortgage Act, 1920 (46 App. U.S.C. 911 et seq.)(including distribution of any proceeds of sale) to foreclose a preferred ship or fleet mortgage in a vessel or a mortgage, deed of trust, or other security interest in a fishing facility held by the Secretary of Commerce under section 207 or title XI of the Merchant Marine Act, 1936, (46 App. U.S.C. 1117, and 1271 et seq., respectively).

The provisions of paragraphs (12) and (13) of this subsection shall apply with respect to any such petition filed on or before December 31, 1989.

(c) Except as provided in subsections (d), (e), and (f) of this section-

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and

(2) the stay of any other act under subsection (a) of this section continues until the earliest of-

(A) the time the case is closed;

(B) the time the case is dismissed; or

(C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied.

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay-

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property under subsection (a) of this section, if

(A) the debtor does not have any equity in such property; and

(B) such property is not necessary to an effective reorganization.

(e) Thirty days after a request under subsection (d) of this section for relief from the stay of any act

against property of the estate under subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the court, after notice and a hearing, orders such stay continued in effect pending the conclusion of, or as a result of, a final hearing and determination under subsection (d) of this section. A hearing under this subsection may be a preliminary hearing, or may be consolidated with the final hearing under subsection (d) of this section. The court shall order such stay continued in effect pending the conclusion of the final hearing under subsection (d) of this section if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the conclusion of such final hearing. If the hearing under this subsection is a preliminary hearing, then such final hearing shall be commenced not later than thirty days after the conclusion of such preliminary hearing.

(f) Upon request of a party in interest, the court, with or without a hearing, shall grant such relief from the stay provided under subsection (a) of this section as is necessary to prevent irreparable damage to the interest of an entity in property, if such interest will suffer such damage before there is an opportunity for notice and a hearing under subsection (d) or (e) of this section.

(g) In any hearing under subsection (d) or (e) of this section

concerning relief from the stay or any act under subsection (a) of this section -

(1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and

(2) the party opposing such relief has the burden of proof on all other issues.

(h) An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.

§541(a): The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is-

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c), or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date -

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except as such are

earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

(b) Property of the estate does not include -

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor; or

(2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to included any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration at the stated term of such lease during the case.

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law -

(A) that restricts or conditions transfer of such interest by the debtor, or

(B) that is conditioned on the insolvency or financial condition of

the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

§543(a) A custodian with knowledge of the commencement of a case under this title concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents,

or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property. .

(b) A custodian shall -

(1) deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case; and

(2) file an accounting of any property of the debtor, or proceeds, product, offspring, rents, or profits of such property, that, at any time, came into the possession, custody, or control of such custodian.

(c) The court, after notice and a hearing, shall -

(1) protects all entities to which a custodian has become obligated with respect to such property or proceeds, product, offspring, rents or profits of such property;

(2) provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian; and

(3) surcharge such custodian, other than an assignee for the

benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, for any improper or excessive disbursement, other than a disbursement that has been made in accordance with applicable law or that has been approved, after notice and a hearing, by a court of competent jurisdiction before the commencement of the case under this title.

(d) After notice and hearing, the bankruptcy court -

(1) may excuse compliance with subsection (a), (b), or (c) of this section, if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property and

(2) shall excuse compliance with subsections (a) and (b)(1) of this section if the custodian is an assignee for the benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, unless compliance with such subsections is necessary to prevent fraud or injustice.

STATEMENT OF THE CASE

A. Introduction to the Facts:

This case emanates from a Chapter 11 bankruptcy proceeding of Berry Estates Inc. ("Berry"), and is based upon a proof of claim filed therein by the Comptroller of the State of New York ("Comptroller"). Federal Jurisdiction is based upon the fact that bankruptcy matters are inherently federal questions. On June 1, 1983, Berry, a landlord in the Village of Spring Valley, New York (the "Village"), was forced into bankruptcy as a result of a foreclosure proceeding by its first mortgagee. See generally, In re Berry Estates, Inc., 34 B.R. 612 (Bktcy. S.D.N.Y. 1983), In re Berry Estates, Inc., 47 B.R. 1004 (Bktcy.S.D.N.Y. 1984). Prior thereto, beginning in 1974, the Village's officials began passing resolutions imposing rent regulation upon certain of the Village's landlords pursuant to New

York's Emergency Tenant Protection Act of 1974 ("ETPA").[1] Berry, as well as the other Village landlords, contested the constitutionality of New York's rent regulation statute as well as the validity of the resolution adopting rent regulation in the Village. In fact, as of the date Berry filed its petition in bankruptcy, June 1, 1983, all resolutions of the Village Board of the Village of Spring Valley declaring a housing emergency, thereby adopting rent regulation had been adjudged invalid.[2] Thereafter, and almost

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1. Under ETPA, CLS Unconsolidated laws of New York, Chap. 249-B, a determination by a municipality of an apartment vacancy rate of less than 5% can be grounds to declare a housing emergency thereby allowing the imposition of rent regulation.

2. A judgment of the Supreme Court of the State of New York, County of Rockland (Hon. Fred A. Dickinson) was entered November 3, 1982 after a trial on the merits. This judgment invalidated rent regulation in the Village of Spring

(footnote continued on next page)

one year after the Chapter 11 petition was filed, the Supreme Court of the State of New York - Appellate Division for the Second Judicial Department reversed the trial court, Spring Valley Gardens Associates v. Marrero, 100 A.D. 93, 474 N.Y.S.2d 311 (2nd Dept. 1984). The Court of Appeals of the State of New York later affirmed the Appellate Divison, 68 N.Y.2d 627, 505 N.Y.S.2d 57 (1986).

As a result of the reversal of the trial court, all of Berry's tenants, during the relevant time periods, were found to have been overcharged rent, although they had always paid the exact rent for which they bargained.

(footnote continued from last page)

Valley, See, Spring Valley Gardens Associates v. Marrero, 100 A.D. 93, 474 N.Y.S.2d 311 (2nd Dept. 1984). However, under ETPA §12(a)(5) (formerly §12 (a)(3)), an appeal by the state automatically stays the effect of a judgment invalidating the adoption of ETPA in a municipality. See e.g, Berry Estates, Inc. v. Marrero, 101 Misc.2d 297, 301, 420 N.Y.S.2d 970 (Sup.Ct. Rockland Cty. 1979)

Consequently, all of these tenants became creditors in the bankruptcy case.

B. The State Court Escrow Order and Claim 200

The basis of the instant dispute is a proof of claim filed by the New York State Comptroller ("Claim 200").[3] As the State of New York was not a creditor of Berry, it is of critical importance to fully discuss the foundation and nature of Claim 200. As will be discussed below, the underlying basis of Claim 200 is a state court order directing Berry to turn over excess rents collected to the tenants aggrieved, or to the Rockland County Clerk's office as custodian for the tenants (the "State Court Order"). The purpose of Claim 200 is an attempt by the Comptroller to enforce that State Court Order in the bankruptcy proccedings.

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3. The Comptroller's proof of claim appears on the Bankruptcy Court's claim docket as Claim 200.

1. The State Court Litigation[4]

Beginning in 1974, Berry, along with other Village landlords, was exposed to repeated attempts by the local officials to impose rent restrictions pursuant to New York's Emergency Tenant Protection Act ("ETPA").

The ETPA provides that where the vacancy rate for the subject

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4. The facts elicited herein are those which are germane to the issues presented. Nevertheless, the Court is respectfully referred to the following reported decisions for a more detailed view of the State Court litigation: Matter of Berry Estates v. Marrero, 101 Misc.2d 297, 420 N.Y.S.2d 970 (Sup.Ct. Rockland Cty. 1979); Matter of Berry Estates v. Marrero, 74 A.D.2d 871, 426 N.Y.S.2d 47 (2nd Dep't 1980); People ex re. Office of Rent Administrator, Division of Housing & Community Renewal v. Mack, 65 A.D.2d 681, (2nd Dep't 1978); People ex re. Office of Rent Administrator, Division of Housing & Community Renewal v. Berry Estates, Inc., 87 A.D.2d 161, 450 N.Y.S.2d 845 (2nd Dep't 1982); Spring Valley Gardens et. al v. Marrero, 100 A.D.2d 93, 474 N.Y.S.2d 311 (2nd. Dep't 1984) aff'd 68 N.Y.2d 627, 505 N.Y.S.2d 57, 496 N.E.2d 216 (1986).

town or village is less than 5%, a local government, pursuant to prescribed methods, may declare that a public emergency exists and impose rent controls. See §3(a) of ETPA at (CLS Unconsolidated laws of New York, Chap. 249 - B).

On December 5, 1978, the Village officials passed a resolution adopting ETPA. As this was the Village's fourth attempt to adopt rent regulation. This resolution has commonly been referred to as "Resolution No. 4".

Initially, Berry unsuccessfully contested ETPA by attacking its constitutionality. Contemporaneously, other landlords in the Village commenced actions in the New York State courts for declaratory relief invalidating Resolution No. 4 (the "Marrero case"). The landlords alleged that the resolution was adopted by a fatally defective procedure. Berry

later joined the other landlords in this attack on Resolution No. 4.

After the Marrero case went to trial, the Supreme Court of the State of New York, County of Rockland, (Dickinson, J.) held that the facts, as presented at trial, were sufficient to indicate that the actions of the Village had not satisfactorily come within the prescriptions of the ETPA and, consequently, held that Resolution No. 4 was invalid. As Berry's contest of Resolution No. 4 was based upon the same facts and arguments as Marrero, the trial court granted Berry summary judgment based upon the principle of collateral estoppel. Thereafter, the Village filed a Notice of Appeal and Berry's case was consolidated with the other Marrero cases.

On March 14, 1984, the Appellate Division for the Second Department, in a three to one majority (with a strong

dissent), reversed the trial court and held that the Resolution No. 4 was validly adopted. See, Spring Valley Gardens, et al. v. Marrero, 100 A.D.2d 93, 474 N.Y.S.2d 311 (2d Dep't. 1984). The Appellate Division decision was appealed to the New York State Court of Appeals which, on June 5, 1986, affirmed the Appellate Division. Spring Valley Gardens, et al. v. Marrero, 68 N.Y. 627, 505 N.Y.S.2d 57, 496 N.E.2d 216 (1986).

During the litigation between the Village landlords and the Village, various orders were made requiring the landlords to escrow excess rents collected with the Office of the Clerk of the County of Rockland. While Berry was taking the constitutionality issue to the New York State Court of Appeals, the New York State Division of Housing and Community Renewal returned to the lower courts to seek

enforcement of the escrow orders through an accounting. Thereafter, the Supreme Court of the State of New York - Appellate Division for the Second Department granted the State's motion for an accounting and "directed the Plaintiffs [Berry] to pay into escrow or return to tenants any amounts collected above the regulated rental level." Berry Estates, Inc. v. State of New York, slip. op. No. 82 Civ. 6465-CSH (S.D.N.Y. March 4, 1983).[5] It is undisputed that Claim 200 deals exclusively with money which was subject to this escrow requirement. These escrow requirements were solely and exclusively

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5. In 1983 Berry brought an action in the United States District Court for the Southern District of New York to attack the constitutionality of ETPA. The District Court in the above-cited decision chose to abstain from addressing the issues until the state courts had the full opportunity to address and resolve the issues presented. Nevertheless, the District Court fully addressed the facts presented, including the escrow order which is the basis of Claim No. 200. Although this case is not reported, it is reprinted in full in the appendix at p. 119.

for the protection of the Village's tenants. At no time was the State of New York given any rights to the excess rents greater than that of a custodian.

2. The Chapter 11

In December, 1981, Berry's mortgage terminated, by its terms and the balloon sum of $2.6 million became due. Berry was unable to reach a refinancing agreement with its mortgagee and, consequently, on or about April 1, 1982, the mortgagee commenced a foreclosure action and a receiver was appointed.

On June 1, 1983, Berry filed for relief under Chapter 11 of Title 11 of the United States Code. It is important to reiterate that at this time Resolution No. 4 had been adjudged invalid, and an appeal by the Village was pending. Thus, it was not unreasonable for Berry to assume, as

it did, that rent regulation had been judicially dissolved in the Village. However, as stated above, on March 14, 1984, over nine months after the Chapter 11 was filed, the trial court invalidation of Resolution No. 4 was reversed. Accordingly, all of Berry's tenants and former tenants during the years of the ETPA litigation became creditors to the extent of rent overcharges.

The ability of New York State to pursue the enforcement of ETPA in the Village of Spring Valley was not impaired by Berry's Chapter 11 filing. The State vigorously assisted the Village in implementing ETPA throughout the Chapter 11 period. The State similarly pursued administrative proceedings liquidating the amount each tenant was overcharged during the Chapter 11 proceeding. And, the State assisted the tenants in protecting their rights in bankruptcy court by helping them file and prosecute proofs of claim. More

importantly, all excess rents, as they were determined in state administrative proceedings, were taken into consideration, and paid in full, in the Chapter 11 proceedings below. Berry emphatically asserts that the persons who were the sole subject beneficiaries of the escrow orders (the tenants of Berry) were not prejudiced by Berry's actions. The facts clearly indicate that the bankruptcy proceedings below gave the tenants more than ample opportunity to present and protect the full amount of their claims, plus interest, for excess rents. The confirmed Plan of Reorganization provides that the claims of the tenant claimants would be unimpaired. The tenants were given due notice of the bankruptcy proceedings; the tenants were aware of their obligation to file claims; and, the tenants were given due notice of the "Bar Dates" fixed by the Bankruptcy Court as the last day to file proofs of claim. Additionally, the State's attorneys assisted the tenants at every step of the bankruptcy proceedings.

3. The Comptroller's Claim

By order dated April 27, 1984, pursuant to Rule 3003(c)(3) of the Rules of Bankruptcy Procedure, the Bankruptcy Court fixed June 15, 1984 as the last day for creditors to file proofs of claim against Berry (the "Bar Date"). This date was later properly extended to November 30, 1984 by the Bankruptcy Court. On June 15, 1984, the Comptroller filed Claim 200. The amount of the claim was the sum total of all potential claims by tenants who had not filed proofs of claim on their own. Indeed, Claim 200 was a class claim for those tenants who had not yet filed their own proofs of claim.

Berry objected to Claim 200 on various grounds, including: a) that the Comptroller's actions in filing a proof of claim were ultra vires; b) that the Comptroller was neither a proper party claimant in these proceedings, nor a

creditor of the debtor; c) that the true creditors who failed to timely file proofs of claim should be barred by the Bar Date; d) that funds ultimately unclaimed by proper party claimants reverted back to Berry under the clear dictates of §347(b) of the Bankruptcy Code; and e) that the State's Claim was an inappropriate and improper attempt to impose a fine against Berry.

The Comptroller, arguing that it had a right to make a claim on his own behalf under §8(11) of New York's State Finance Law, asserted that its claim should be allowed in full. Section 8(11) of the New York State Finance Law provides that the Comptroller is empowered to enforce orders to pay money into state court. Thus, the basis for the Comptroller's argument was that he, as the overseer of the custodian (the Rockland County Clerk) of funds to be escrowed for the benefit of tenants, had a debtor-creditor relationship with Berry.

The Comptroller expressly argued that it was seeking this money only to enforce the state court escrow orders and not as a punitive measure against Berry.[6] The Comptroller further argued that all unclaimed funds should not revert to the

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6. In his reply Memorandum of Law at the bankruptcy court level the Comptroller asserted:

> Berry also argues that the overcharges found by the [New York State] Division [of Housing and Community Renewal (which is the basis of the Comptroller's claim)] in the administrative proceedings are analogous to a criminal fine. A review of the Order and Determination (Exhibit 39 [to the affidavit of Lawrence Alexander, Esq. in support of the Comptroller's claim]) shows that this argument is factually and legally incorrect. No fine was imposed; no treble damage award was issued by the Division, but it merely calculated the amount of the overcharges.

Indeed there is no dispute between the parties as to whether the Comptroller's claim, or the state court order upon which it was based, was punitive in nature. It was not. Nevertheless, the Second Circuit's decision recasts this contingent debt as punitive.

debtor under the clear dictates of 11 U.S.C. §347(b), but be held, in perpetuity, by the State on behalf of the tenants who failed to file claims. The Comptroller used the specious tautological argument that 11 U.S.C. §347(b) did not apply because there were no unclaimed funds - the Comptroller had claimed all the unclaimed funds.

3. The Decisions Below

In its decision and order, the Bankruptcy Court held, inter alia, that the Comptroller would be considered a creditor only for the purpose of further protecting tenants who had failed to timely file proofs of claim. As such, the Bar Date, pursuant to Rule 3003 of the Rules of Bankruptcy Procedure, for tenant claimants only, would be extended approximately one additional year so as to allow the Comptroller additional time to locate those tenants and assist them in filing

claims. In other words, the Bankruptcy Court allowed the Comptroller's Claim for the express purpose of extending the Bar Date for the tenant class of creditors. Additionally, the bankruptcy court held that any funds not claimed by the new deadline would, pursuant to §347(b) of the Bankruptcy Code, revert back to the debtor. In re Berry Estates, Inc., 49 B.R. 1002 (Bktcy. S.D.N.Y. 1985)

Subsequent to the Bankruptcy Court's order, the Comptroller filed a Notice of Appeal. Thereafter, Berry noticed its cross-appeal. The District Court affirmed the Bankruptcy Court's decision in toto.[7]

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7. The District Court asserted:

> As did the Bankruptcy Court, this Court rejects the rather fantastic notion that the State of New York or its Comptroller, pursuant to the New York Abandoned Property Law, can claim, or collect, funds due to absent creditors of a Debtor in Reorganization under the Federal Bankruptcy Code, which would otherwise become in effect part of the

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Thereafter, both Berry and the Comptroller filed their respective Notices of Appeal to the Court of Appeals for the Second

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> Debtor's Estate simply because debtors [sic] [creditors] failed to file a timely proof of claim. The Bankruptcy Code is a complete legislative scheme of Congress, national in scope, in an area of law preempted by the United States Constitution. The concept that the Court should establish a Bar Claim date, and that funds due creditors who do not perfect their claims in a timely manner should become the property of the Debtor in Reorganiztion, or the other creditors, is so significant a part of the legislative scheme as to be immune from alteration or distortion at the behest of state officials seeking to enforce state laws affecting escheat or the custody of abandoned property. [cite] Furthermore, the State Comptroller, considered in his own capacity as acting under the New York Abandoned Property Law, or as an auditor and supervisor of the financial affairs of the Clerk of Rockland County, who is also Clerk of the Supreme Court of the State of New York in Rockland County, is not a creditor of Berry. At most he is a statutory custodian, in perpetuity, for the choses in action or funds of the tenants, who are the true creditors. [cites]

Judicial Circuit. The Court of Appeals, recharacterizing the escrow orders as punitive, reversed the District Court and Bankruptcy Court holding that Berry does not have a right to the unclaimed funds regardless of the clear dictates of Bankruptcy Code §§541, 543 and 347(b). Under the Second Circuit's reasoning, it is simply better to give the State of New York a windfall rather than allow a debtor to keep unclaimed rent overcharges.

REASONS FOR GRANTING THE WRIT

I. Certiorari Should Be Granted To Resolve Conflicts In Principle Among The Lower Courts, And Where The Court Of Appeals Has So Far Departed From The Accepted And Usual Course Of Judicial Proceedings.

The central issue in this case is what steps a state can take to circumvent the federal Bankruptcy Code so that a state's interests, when in conflict with the federal bankruptcy scheme, may survive. It is clear that the legislature considered this issue when the Bankruptcy Code was drafted. The Bankruptcy Code

provides that debts in the nature of a "fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and [which] is not compensation for actual pecuniary loss" is not dischargeable in bankruptcy (§523(a)(7)). See generally, Kelly v Robinson, 479 U.S. ___, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986). Also, the Bankruptcy Code provides that the automatic stay contained in §362(a) thereof does not apply to the "commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power" (§362(b)(4)), or the "enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power" (§362(b)(5)) (emphasis added). See generally, Midlantic National Bank v. New Jersey Department of

Environmental Protection, 474 U.S. 106, 106 S.Ct. 755, 88 L.Ed. 859 (1986). Thus, the issue becomes how far, in the name of "police power", may a state go to avoid the clear prescriptions delineated in the Bankruptcy Code.

Although not precisely on point with the facts of this case, in three cases, Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. ___, 107 S.Ct. 755, 88 L.Ed. 859 (1986), Kelly v. Robinson, 479 U.S. __, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) and Ohio v. Kovacs, 469 U.S. 274, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985), this Court addressed situations where states' regulatory and/or policing statutes were in conflict with the Bankruptcy Code. In Midlantic, this Court, citing legislative history, noted, that "§362(b)(5) permits the government to enforce 'nonmonetary' judgments against a debtor's estate."

(emphasis added) 474 U.S. at ___, 106 S.Ct. at ___, 88 L.Ed. at 867 (1986). In Kelly v. Robinson, supra, this Court detailed the notion of penal sanctions which would make a debt nondischargeable and therefore relieve a state of the effects of bankruptcy administration with respect thereto. This Court noted that "Congress included two qualifying phrases: the fines must be 'to and for the benefit of a governmental unit,' and 'not compensation for actual pecuniary loss.'" 479 U.S. at __, 106 S.Ct. at __, 93 L.Ed.2d at 230 (1986). Although neither of the parties herein view the escrow order in question as punitive, one can only infer from the Second Circuit's decision that it believed Berry acted improperly and thus should not be permitted to keep the tenants' unclaimed property. From this readily apparent basis for the Second Circuit's decision, it is easy to infer that the Second

Circuit, citing Midlantic National Bank v. New Jersey Department of Environmental Protection, supra and Kelly v. Robinson, supra, recast the subject escrow order into a penalty. Finally, in Ohio v. Kovacs, supra, this Court recognized that certain "equitable obligations" imposed on a debtor by a state regulatory authority are really claims for money and, as such, are dischargeable in bankruptcy. In so holding, this Court noted that a state's police powers which survive the filing of a bankruptcy petition are those which are purely punitive and not pecuniary in nature, 469 U.S. at __, 105 S.Ct. at __, 83 L.Ed.2d at 658, 59.

With regard to the issue of the extent to which a state, under the banner of "police power", could act when that power may be in conflict with the bankruptcy statutes, the lower courts, with the

exception of the Second Circuit's decision below, have been relatively consistent. The courts have ruled that bankruptcy jurisdiction supersedes state's policing and or regulatory function, except where the activities of the state relate to non-pecuniary matters which are pursued to enforce regulations to protect the public welfare.

The Second Circuit carved out a new exception to the protections afforded by the Bankruptcy Code. Specifically, the Second Circuit's decision allows a state, which prior to the bankruptcy acted as an escrow custodian for certain creditors whose whereabouts have been unknown for many years, the ability to file a proof of claim on behalf of these missing escrow beneficiaries. This results in permitting the state to administer a bankruptcy debtor's property outside the statutory scheme by holding the property of the

debtor in perpetuity for creditors who, after a more than adequate opportunity is granted to file a claim, failed to properly file a proof of claim in the bankruptcy proceedings. As the record in this case reflects, most, if not all of the creditors herein who failed to file proofs of claim are nowhere to be found. In fact, there have been considerable efforts made by the state, as well as by independent interested parties, to locate these "unknown" creditors. Thus, the practical result of the Second Circuit's decision will be that the State of New York will be actually enriched by being able to add all the unclaimed monies to the State's treasury. All this, under the guise of "police power" and in derogation of Bankruptcy Code sections 541,[6] 543[7] and

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6. Section 541 of the Bankruptcy Code broadly defines Property of the bankruptcy estate as all legal and equitable interests of the debtor whereever located. The only limitations on this broad

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347(b)[8], and Bankruptcy Rule 3003[9]. This exception is not only in direct conflict with the clear statutory language, but is also in conflict with cases decided in other circuits.

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definition are found in §541(b) (any power that the debtor may excercise solely for the benefit of an entity other than the debtor); and §541(c)(2) (a restriction on the transfer of a beneficial interest of the debtor in a trust). It is well settled that property held by a custodian is property of the estate. See §543.

7. Section 543 of the Bankruptcy Code provides that a custodian must not, with limited exceptions, take any steps to administer the property he holds, and he must turn over the property he holds to the trustee in bankruptcy. Under 11 U.S.C. §1107(a) a debtor in possession has all the powers of a trustee.

8. Section 347(b) of the Bankruptcy Code provides that any property unclaimed by bona fide creditors at the end of a Chapter 11 bankruptcy proceeding reverts back to, and becomes property of the debtor.

9. Bankruptcy Rule 3003 provides that a creditor must file his proof of claim within the time duly set by the bankruptcy court.

In State of Missouri v. U.S. Bankruptcy Court for the E. D. of Arkansas, 647 F.2d 768 (8th Cir. 1981), cert. denied 454 U.S. 1162, 102 S.Ct. 1035, 71 L.Ed.2d 318 (1982) the issue presented was whether the State of Missouri, by asserting its own statutory police power could prevent the United States Bankruptcy Court from exercising jurisdiction over grain warehouses located in the State of Missouri owned by an Arkansas debtor who filed for relief under the Bankruptcy Code. The State of Missouri argued that it should be authorized to liquidate the grain contained in these warehouses in accordance with the provisions of the Missouri Code and under the aegis of the Missouri Department of Agriculture.

The Eighth Circuit affirmed the decisions of the lower courts that the grain is property of the bankruptcy estate as defined by §541 of the Bank-

ruptcy Code and any competing claims between the State of Missouri and the Bankruptcy Court must be determined in favor of the Bankruptcy Court due to federal supremacy. In discussing the concept of a state's police power in relation to a bankruptcy court proceeding, the Eighth Circuit reviewed the appropriate legislative history[10] and

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10. The Eight Circuit cited the following legislative history in explaining the limits of the §362(b)(4) and (b)(5) police power exception to exclusive bankruptcy jurisdiction over the debtor.

> Paragraph (4) excepts commencement or continuation of actions and proceedings by governmental units to enforce police or regulatory powers. Thus, where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the automatic stay. Paragraph (5) makes clear that the exception extends to permit an injunction and enforcement of an injunction, and to permit the entry of a money judgment, but does not
> (footnote continued on next page)

asserted:

> In light of the legislative history and court decisions under the earlier bankruptcy act, we believe that the term "police or regulatory power" refers to the enforcement of state laws affecting health, welfare, morals, and safety, but not regulatory laws that directly conflict with the control of the res or property by the bankruptcy court. ...
>
> We conclude that Missouri's

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> extend to permit enforcement of a money judgment. ... [H.R.Rep.No. 595, 95th Cong., 1st Sess. 343 (1977), reprinted in [1978] U.S. Code Cong. & Ad.News 5963, 6299.]

Further, the Eighth Circuit noted that Congressman Don Edwards, Chairman of a subcommittee of the Judiciary Committee considering the Bankruptcy Code, observed:

> This section [362(b)(4)] is intended to be given a narrow construction in order to permit government units to pursue actions to protect the public health and safety and not to apply to actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate. [124 Cong.Record H 11089, reprinted in [1978] U.S.Code Cong. & Ad.News 5436,,6444-6445.]

> grain laws, although regulatory in nature, primarily relate to the protection of the pecuniary interest in the debtors' property and not to matters of public safety and health. Missouri's laws, by governing the operation and liquidation of grain warehouses directly conflict with the control of the property by the bankruptcy court and, therefore, do not fall within the section 362(b)(4) exception.
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> * * *
>
> It is well settled that a bankruptcy action preempts state insolvency proceedings. "The bankruptcy law is paramount, and the jurisdiction of the Federal courts in bankruptcy, when properly invoked, in the administration of the affairs of insolvent persons and corporations, is essentially exclusive." In re Watts and Sachs, 190 U.S. 1, 27, 23 S.Ct. 718, 724, 47 L.Ed. 933 (1903). (emphasis added)

647 F.2d at 776.

In Cash Currency Exchange, Inc., 762 F.2d 542 (7th Cir 1985), cert. denied, 106 S.Ct. 233 (1986), the issue presented was whether a business engaged in cashing checks and money orders may be a debtor under the Bankruptcy Code, and if so, what effect does filing a bankruptcy petition

have on state court receiverships placed on the debtor by a regulatory agency of a state. The Seventh Circuit affirmed the lower courts' holding that the debtor could seek relief in the bankruptcy court, and that all of the debtor's property becomes part of the bankruptcy estate regardless of the state statute which provides that an adminstrative receiver's title to assets is exclusive. In holding that all of the debtor's property becomes part of the bankruptcy estate to be administered solely through the bankruptcy proceedings, the Seventh Circuit clearly noted that property in the hands of a custodian must be turned over to the bankruptcy court for administration regardless of the nature of the custodianship. The Seventh Circuit stated:

> As the legislative history illustrates, the categories of custodians are descriptive rather than exhaustive. Congress defined the term broadly to include third

parties who have taken charge of the debtor's assets for the general benefit of creditors. [cites] The Director's receiver falls within this broad class of prepetition liquidators.

We fail to understand how the fact that the Director's receiver - as distinguished from a court- appointed receiver - holds title to the exchanges' assets undermines our conclusion. We find no indication that Congress intended to limit the term "custodian" to those prepetition liquidators who merely hold the debtor's property. Indeed, the legislative history of section 543 supports the conclusion that the term "custodian" includes prepetition liquidators who hold title to the debtor's assets. ...

The legislative history of this section [543] provides, in pertinent part, that:

> This section requires a custodian appointed before the bankruptcy case to deliver to the trustee and to account for property that has come into his possession, custody, or control as a custodian. "Property of the debtor" in section (a) includes property that was property of the debtor at the time the custodian took the property, but the title to which passed to the custodian.

H.R.Rep. No. 595, 95th Cong., 1st Sess. 370 (1977); S.Rep. No. 989, 95th Cong., 2d Sess. 84 (1978), U.S.Code Cong. & Admin.News, pp. 5787, 5870, 6326 (emphasis added by Seventh Circuit).

In State of Texas v. Wellington Resources Corp., 706 F.2d 533 (5th Cir. 1983), the issue presented was whether the State of Texas could, through the institution of a securities fraud case, successfully file an application to release from the bankruptcy proceedings property of the debtor corporation over which the state had previously exercised jurisdiction. The Fifth Circuit affirmed the lower courts' decisions denying Texas' application. The Fifth Circuit reviewed the statute defining property of a bankruptcy estate (11 U.S.C. §541) and held that the administration of these assets was exclusively vested with the bankruptcy court, to be administered through the bankruptcy proceedings. Therefore, the Fifth Circuit held that the bankruptcy court did not impermissibly interfere with the pending state judicial proceedings which were

instituted by the state to enforce the Texas Security Act. See also In re Mansfield Tire & Rubber Co., 660 F.2d 1108 (6th Cir. 1981) holding that worker's compensation proceedings were not automatically stayed where the benefits were to be paid from an insurance fund or from security bonds which were not the debtor's property; Equal Employment Opportunity Commission v. Rath Packing Company, 787 F.2d 318 (8th Cir. 1986) holding that a non-pecuniary action by a government entity to vindicate the public interest in preventing employment discrimination is not affected by bankruptcy proceedings; and Cournoyer v. Town of Lincoln, 790 F.2d 971 (1st Cir. 1986) holding that where a town's actions to enforce zoning regulations do not impair a debtor's property rights nor adversely affect any pecuniary interests, the town may continue with its enforcement actions

regardless of a pending bankruptcy proceeding.

In In re Cannon, 741 F.2d 1139 (8th Cir. 1984) the Eighth Circuit contemplated a scenario squarely on point with the case at bar - the power of a state to enforce pecuniary rights of its citizens in a bankruptcy case. In the Cannon case, the State of Missouri filed a complaint in the Bankruptcy Court on behalf of individuals who were entitled to restitution for violations of that state's Fair Merchandising Practices Act.[12] Under

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12. The term "restitution" used by the Eighth Circuit was not criminal or penal in nature, but related to the State of Missouri's successful civil prosecution of the Debtor's violation of Missouri's Merchandising Practices Act. Accordingly, like the instant case, the debt was not a fine or penalty, but rather a simply civil pecuniary judgment. It is respectfully submitted that this would distinguish it from the holding in Kelly v. Robinson, 479 U.S. __, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) (holding criminal restitution to be nondischargable in bankruptcy). The debt in the instant case has never been considered penal in nature, nor has anyone termed it "restitution."

§§407.010 and 407.100 of the Fair Merchandising Practices Act of Missouri, the Attorney General of the State of Missouri is empowered to bring actions to enforce the Merchandising Act. These powers are functionally equivalent to the powers of New York State's Division of Housing and Communitity Renewal under ETPA. The issue presented to the Eighth Circuit was whether the state was a "creditor" giving it standing to challenge the dischargeability of debts on behalf of consumer creditors.

The Eighth Circuit held that the state was <u>not</u> a creditor because under the Missouri Merchandising Practices Act the consumers harmed by proscribed acts have a private right of action and thus have the independent responsibility to pursue their own legal rights. This is exactly the situation which exists in the case at bar. The statutory scheme of the ETPA speci

fically provides that the tenants have a private right of action if they are wronged by landlord's acts in violation of the ETPA.

It must be emphasized that Berry's Chapter 11 proceeding never limited the State's regulatory rights to pursue enforcement of ETPA. The State vigorously assisted the Village in implementing ETPA. The State actively pursued administrative proceedings liquidating the amount that each tenant was overcharged. The State further assisted the tenants in protecting their rights in bankruptcy court by helping them file and prosecute proofs of claim. Thus, the issue here is not whether a state could enforce their own non-pecuniary regulations. The law is clear that the enforcement of nonpecuniary regulations by governmental agencies are not disturbed by the filing of a bankruptcy petition. The issue is whether a state official, who is a custodian of

state escrow orders, can, in the name of "police power", make a non-punitive pecuniary claim for the benefit of other claimants. It is respectfully submitted that under the above cited case law of the First, Sixth, Seventh, and Eighth Circuits, a state is precluded from enforcing nonpunitive pecuniary rights on behalf of its citizens. This is even more important when one considers that after due diligence, and after more than ample opportunity is afforded to enforce the claimants private rights, those intended to be protected can not be found. The Second Circuit's decision in this case allows a state to continue to administer a debtor's property by filing a proof of claim on behalf of others, who cannot be located, thereby taking the property out of the bankruptcy proceedings, and thus circumventing the clear mandates of Title 11. The end result of such a decision is a complete disregard of Title 11, §§541, 543 and 347, and an improper windfall to the

State of New York.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 186, 185—August Term, 1986

(Argued: September 22, 1986

Decided: February 19, 1987)

Docket Nos. 86-5029, 86-5037

IN RE: BERRY ESTATES, INC, d/b/a BLUEBERRY HILL MANAGEMENT CORP.,

Debtor.

BERRY ESTATES, INC.,

Plaintiff-Appellant,

— v. —

STATE OF NEW YORK,

Defendant-Appellee.

HON. EDWARD REGAN, COMPTROLLER OF THE STATE OF NEW YORK, STATE CAPITOL,

Plaintiff-Appellant,

— v. —

BERRY ESTATES, INC.,

Defendant-Appellee.

Before:

VAN GRAAFEILAND, MESKILL and NEWMAN,
Circuit Judges.

Appeal and cross-appeal from an order of the United States District Court for the Southern District of New York (Brieant, J.), affirming an order of the United States Bankruptcy Court. Affirmed in part and reversed in part.

DAVID S. COOK, Senior Att'y, N.Y., N.Y., (Robert Abrams, Att'y Gen. of the State of New York and Richard G. Liskov, Ass't Att'y Gen., of Counsel), *for Defendant-Appellee.*

JOSEPH J. HASPEL, Spring Valley, N.Y., (Barr and Faerber, Spring Valley, N.Y., of Counsel), *for Plaintiffs-Appellant.*

VAN GRAAFEILAND, *Circuit Judge:*

These are appeals from an order of the United States District Court for the Southern District of New York (Brieant, J.) affirming an order of the bankruptcy court. The issue presented is whether certain orders of New York State courts under that State's Emergency Tenant Protection Act of Nineteen Seventy-Four (ETPA), N.Y. Unconsol. Laws §§ 8621-8634, should control the disposition of

unlawful excess rents collected by a landlord who thereafter filed for a Chapter 11 arrangement, 11 U.S.C. §§ 1101-1174. A brief look at the public policy underlying rent control laws, such as the ETPA, is an appropriate starting point for our discussion.

Rent control legislation has been a vital part of the American scene since World War I. *See Block v. Hirsh,* 256 U.S. 135, 153 (1921); *People ex rel. Durham Realty Corp. v. La Fetra,* 230 N.Y. 429, *appeal dismissed,* 257 U.S. 665 (1921). Constitutional challenges to such legislation consistently have been rejected. *Israel v. City Rent and Rehabilitation Administration,* 285 F. Supp. 908, 910 (S.D.N.Y. 1968). Federal and State courts have held that limitation on rents is not a taking of property. *Bowles v. Willingham,* 321 U.S. 503, 517 (1944); *Teeval Co. v. Stern,* 301 N.Y. 346, 362, *cert. denied,* 340 U.S. 876 (1950). The New York Court of Appeals has characterized rental as an instrument of oppression, which may be regulated in the public good. *People ex rel. Durham, supra,* 230 N.Y. at 451-52.

Because rent control statutes are police power statutes enacted for the benefit of the general public, landlords are not permitted to evade them, whether by subterfuge, mistake, or otherwise. "Knowledge on the part of a landlord that he cannot escape liability for excess payments of rent under *any* circumstances, tends to insure compliance with the statute. The obtaining of excessive rents strikes at the very purpose of the act." *Estro Chemical Co. v. Falk,* 303 N.Y. 83, 86-87 (1951) (emphasis in original). The public policy underlying rent control legislation militates against the collection or retention of such excess payments. *United States v. Moore,* 340 U.S. 616, 619 (1951); *Hansen v. United States,* 340 F.2d 142, 144-45 (8th Cir. 1965);

Sylvester v. Bernstein, 283 A.D. 333, 338, *aff'd,* 307 N.Y. 778 (1954). "[A] person should not be permitted to retain that which is illegally acquired even through a mistake of legality." *Woods v. Kaye,* 175 F.2d 886, 889 (9th Cir. 1949); *see Woods v. Richman,* 174 F.2d 614, 616 (9th Cir. 1949). Neither should a landlord be able to avoid the statutory restrictions by agreement with or waiver of his tenant. *Thomas v. United States,* 200 F.2d 686, 689 (1st Cir. 1952); *Estro Chemical Co. v. Falk, supra,* 303 N.Y. at 87; *Norms Realty Corp. v. Rodriguez,* 108 Misc. 2d 124, 126-27 (1981).

The courts of New York squarely hold that city and State housing laws are to be obeyed and "none shall benefit from a violation thereof even though the victim may not choose to complain." *Meyer & Steffens, Inc. v. Popolizzio,* 124 Misc. 2d 159, 160 (1984). Thus, in *Matter of Plaza Realty Investors and Queens Blvd. Properties Co. v. New York City Conciliation and Appeals Board,* 111 A.D.2d 395 (1985) (*mem.*), a proceeding under the Code of the Rent Stabilization Association of New York City, Inc., where the New York City Conciliation and Appeals Board ordered that excess rentals be placed in an escrow account and refunds uncollected by tenants be forfeited to the Board, the court held:

> Converting the refund to the prior tenants into a fine should the prior tenants not claim the refund guaranteed that petitioner [the landlord] would not benefit from its misconduct.

Id. at 397. See also N.Y. Penal Law § 180.55 which makes rent gouging a misdemeanor.

When the ETPA was enacted in 1974, the New York Legislature found:

> that a substantial number of persons residing in housing not presently subject to the provisions of the emergency housing rent control law or the local emergency housing rent control act are being charged excessive and unwarranted rents and rent increases; that preventive action by the legislature continues to be imperative in order to prevent exaction of unjust, unreasonable and oppressive rents and rental agreements and to forestall profiteering, speculation and other disruptive practices tending to produce threats to the public health, safety and general welfare; that in order to prevent uncertainty, hardship and dislocation, the provisions of this act are necessary and designed to protect the public health, safety and general welfare ....

N.Y. Unconsol. Laws § 8622.

To carry out the policy thus expressed, the ETPA empowers a municipality to declare an emergency as to any class of housing if the vacancy rate for those accommodations does not exceed five percent. *Id.* § 8623. Once an emergency is declared, a landlord is prohibited from collecting more than the legal regulated rent. *Id.* § 8626. Both the statute and the regulations enacted pursuant thereto provide that any agreement by a tenant to waive the benefits of the Act shall be void as contrary to public policy. *Id.* § 8631; Emergency Tenant Protection Regulations § 2500.12. Section 2505.1 of the Regulations makes it "unlawful ... for any person to demand or receive any rent for any housing accommodations in excess of the legal regulated rent ...."

Berry Estates, Inc. is the owner of an apartment complex in Spring Valley, New York, whose rents have been set by the New York Division of Housing and Commu-

nity Renewal (the Division) in accordance with the foregoing provisions and section 8629 of the ETPA. In 1979, Berry commenced an article 78 proceeding, N.Y. Civ. Prac. Law §§ 7801-7806, against the Division, in which it challenged the ETPA's constitutionality. The Division simultaneously sought to enjoin Berry from collecting rents in excess of the regulated rate. The trial court dismissed Berry's petition and granted the Division's request for a temporary injunction. *Berry Estates v. Marrero,* 101 Misc. 2d 297 (1979). The Appellate Division reversed the dismissal and modified the injunction to allow Berry to continue collecting market rate rents, to be escrowed, however, as follows:

> [E]ach of the defendants is directed to deposit with the Clerk of the Supreme Court, Rockland County, any rents collected in excess of the applicable legal regulated rents herein, to be held in escrow by said clerk during the pendency of the injunction action; in the event that the defendants prevail in the injunction action, said clerk shall pay the funds held in escrow to the defendants; in the event that the plaintiff prevails, the funds held in escrow shall be returned to the tenants from whom they were collected, in such manner as shall be prescribed by Special Term in the final judgment. In the event that the defendants shall fail to deposit any such excess rents into court as directed herein, and upon the plaintiff's application to Special Term, a full preliminary injunction against the collection of rents in excess of the legal regulated limit shall issue.

74 A.D.2d 871, 871-72 (1980).

After a joint trial of Berry's claim and the Division's request for a permanent injunction, the trial court upheld

the Division's enforcement of the ETPA and permanently enjoined Berry from collecting rents in excess of the regulated rate. Berry also was directed to return to the tenants any excess rents collected that were not escrowed with the Rockland County Clerk. The judgment was affirmed by both the Appellate Division, 87 A.D.2d 161, and the Court of Appeals, 58 N.Y.2d 701 (1982). Following the Court of Appeals' affirmance, the Division moved in the Appellate Division for an accounting by Berry of all excess rents that it had collected. The court granted the motion and ordered that Berry pay the Rockland County Clerk all sums collected in excess of the legal regulated rent that had not previously been placed in escrow.

On August 3, 1982, while the appeal from the original Appellate Division decision was pending in the Court of Appeals, Berry began a collateral attack on Spring Valley's declaration of emergency, on the ground that the emergency resolution had not been validly enacted. *Berry Estates v. Village of Spring Valley,* No. 4953/82 (Sup. Ct. Rockland Cty. 1982). Berry secured a temporary restraining order from Judge Marbach allowing it to collect excess rents and place them in escrow with the Rockland County Clerk.

Meanwhile, other Spring Valley landlords had launched a separate attack on the validity of the emergency resolution, and, on September 13, 1982, Judge Dickinson upheld their claim. *Spring Valley Garden Assocs. v. Marrero,* Nos. 7542/80, 2801/81, 2394/81 (Sup. Ct. Rockland Cty. 1982). He ordered that all escrowed funds be returned to the landlords on November 3. Two weeks later, Judge Marbach held that the resolution was invalid as to Berry under the doctrine of collateral estoppel. Judge Marbach ordered that the rents escrowed as a result of his

August 3 order be refunded to Berry. However, he declined to extend his order to include funds subject to other litigation in which Berry was involved.

The Village filed a notice of appeal, which automatically stayed enforcement of Judge Marbach's order. N.Y. Civ. Prac. Law § 5519(a)(1). The Appellate Division denied Berry's motion to vacate the automatic stay, and consolidated seven actions which challenged the validity of the Spring Valley resolution. On March 14, 1984, the Appellate Division reversed the Supreme Court and ordered that the funds escrowed with the Rockland County Clerk be returned to the tenants. *Spring Valley Garden Assocs. v. Marrero,* 100 A.D.2d 93. The Court of Appeals affirmed. 505 N.Y.S.2d 57 (1986).

On June 1, 1983, following the appeal by the Division from Judge Marbach's November 1982 order, Berry filed a voluntary petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 1101-1174. On June 15, 1984, the Comptroller of the State of New York filed a claim for $500,000 (later reduced to $324,446.47), the amount that Berry had failed to deposit in escrow with the Rockland County Clerk or return to the tenants, as directed by the State courts. The Comptroller based his claim on N.Y. State Finance Law § 8(11), which authorized him to enforce orders for the deposit of moneys into court. The bankruptcy judge held that the Division, not the Comptroller, was the proper creditor under 11 U.S.C. § 101(9)(A). He found that the Division's claim was valid and ordered that the excess rents be deposited with the United States Trustee for the Southern District of New York. He ordered further that tenants and former tenants could file claims for the excess rents until June 15, 1986, after which any unclaimed funds would revert to Berry.

On appeal by both parties, the district court affirmed in substance the bankruptcy court's order. Both sides have appealed. The question we now must answer is whether the bankruptcy judge was free to disregard the public policy underlying the ETPA and order that excess rentals unclaimed by former tenants be paid over to the wrongdoing landlord. We conclude that he was not.

We hold at the outset that section 362 of the Bankruptcy Code, 11 U.S.C. § 362, which mandates a broad stay of litigation against the debtor, did not invalidate any of the State court proceedings that followed Berry's Chapter 11 petition. Section 362(b)(4) specifically excepts from an automatic stay "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power." Inasmuch as there are no other creditors to be harmed by the State courts' orders, those orders appear to fall within this exception. *See Matter of Vintero,* 735 F.2d 740, 742 (2d Cir.), *cert. denied,* 469 U.S. 1087 (1984); *Penn Terra Ltd. v. Dep't of Environmental Resources,* 733 F.2d 267, 271-78 (3d Cir. 1984). Moreover, whether an action is by or against a debtor is determined by the debtor's status at the time the action was begun, not by who was ahead when the bankruptcy petition was filed. *Teachers Ins. & Annuity Ass'n of America v. Butler,* 803 F.2d 61, 64-65 (2d Cir. 1986); *Commerzanstalt v. Telewide Systems, Inc.,* 790 F.2d 206, 207 (2d Cir. 1986). The State court actions were brought by Berry and were not subject to either an automatic stay, *see Association of St. Croix Condominium Owners v. St. Croix Hotel Corp.,* 682 F.2d 446, 449 (3d Cir. 1982), or an ordered stay. This being so, the bankruptcy court was not justified in disregarding the State court orders designed to prevent Berry from profiting from its misconduct.

Congress did not intend for bankruptcy laws to abrogate the States' police powers. *Kelly v. Robinson,* 107 S. Ct. 353, 360-61 (1986); *Midlantic Nat'l Bank v. New Jersey Dep't of Environmental Protection,* 106 S. Ct. 755, 760-62 (1986); *Ohio v. Kovacs,* 469 U.S. 274, 285 (1985); *Matter of Quanta Resources Corp.,* 739 F.2d 912, 918-21 (3d Cir. 1984). *order following remand affirmed, Midlantic, supra.* Neither did it intend that the bankruptcy court be a haven for wrongdoers. *In re Flight Transp. Corp. Securities Litigation,* 730 F.2d 1128, 1136-37 (8th Cir.), *cert. denied,* 469 U.S. 1207 (1985); *In re Teltronics, Ltd.,* 649 F.2d 1236, 1239-42 (7th Cir. 1981); 2 *Collier on Bankruptcy* ¶ 362.05, at 362-42. A determination in bankruptcy that Berry was entitled to keep the unrefunded excess rents would fly in the face of New York State's regulatory powers and the deference pledged to them by the bankruptcy laws. Where, as here, no claims of other creditors are involved, it would allow a landlord, who has disregarded the orders of the New York courts, to profit by its misconduct. We do not believe that Congress intended such a perverse result when it enacted the Bankruptcy Code in 1978.

We find no merit in Berry's argument that the Comptroller was unauthorized to seek enforcement of the State courts' escrow orders by filing a claim in the bankruptcy proceedings. *See Ohio v. Kovacs,* 469 U.S. 274 (1985); *Nathanson v. NLRB,* 344 U.S. 25, 27 (1952); 11 U.S.C. § 501(b). The Comptroller is the person designated by the New York Legislature to enforce obedience to court orders requiring the deposit of moneys with the court or its clerk. *See Gardner v. New Jersey,* 329 U.S. 574-75 (1947). We likewise find no abuse of discretion in the bankruptcy court's decision to extend the time in which

tenants might file for refunds. *See* Bankruptcy Rule 3003(c)(3).

The order of the district court is affirmed except as to that part which disallows the claim of the Comptroller, which is reversed. The district court is instructed to remand the matter to the bankruptcy court with instructions that excess rentals not refunded to tenants be paid to the Rockland County Clerk, as ordered by the New York courts.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- - - - - - - - - - - - - - - - -x

In re

BERRY ESTATES, INC., d/b/a
BLUEBERRY MANAGEMENT CORP.

Debtor.

- - - - - - - - - - - - - - - - -x

MEMORANDUM
AND ORDER

85 Civ.9308
85 Civ.9510
86 Civ.0988

(83B 20284)

Brieant, J.

In this rather unusual Chapter 11 proceeding, the parties present the following appeals: 1) the Comptroller of the State of New York appeals in Docket No. 85 Civ. 9308 from that part of an order of the Bankruptcy Court dated July 3, 1985 which denied his motion to allow his claim to refunds of rent made in behalf of former tenants of an apartment complex in Rockland County operated by the Debtor; 2) the Debtor appeals in Docket No. 85 Civ. 9510 from those parts of the July 3, 1985 order which allowed the claim

of the Comptroller in part, as discussed in greater detail below, and extended the Bar Claim date; 3) the Debtor appeals in Docket No. 86 Civ. 0988 from an order dated December 26, 1985 which permitted the New York State Division of Housing and Community Renewal to answer and appear in support of tenants' claims for refunds contested by the Debtor.

Familiarity of the reader with the decisions of the Bankruptcy Court (Schwartzberg, J.) dated June 4, 1985 and November 15, 1985 is assumed.

The underlying facts are essentially as follows: The debtor was and is the owner of a rental apartment complex located in the Village of Spring Valley, Rockland County, New York (the "Village"). On June 1, 1983 Berry filed a voluntary petition pursuant to Chapter 11 of the Bankruptcy Code. This action was a lawful tactical ploy on the part of the debtor to

deal with the problems presented by the pending mortgage foreclosure and also to resist the imposition of rent control by the Village. The Debtor, prior to seeking refuge in the Bankruptcy Court had contested in the state courts the efforts by the Village to impose rent control, as did other local landlords. This litigation had resulted in a requirement to make refunds to tenants in the event rent control was upheld, and to escrow the purported overcharges. Even with rent control, the apartment complex was economically viable upon obtaining mortgage refinancing.

Immediately following the filing of the petition, the New York State Division of Housing and Community Renewal, represented by the Attorney General, moved in the reorganization proceedings for an order from the Bankruptcy Court limiting the stay, so as to require the Debtor to

collect no more than the legal regulated rent under the New York Emergency Tenant Protection Act of 1974. The stay consequent upon the filing of the Chapter 11 petition had temporarily prevented efforts by the tenants and the state to impose and make effective against the Debtor the limitations on the rent which could be collected, while the Debtor and others were contesting the validity of the actions of the Village. Intervention was granted by the Bankruptcy Court and the stay order was modified to limit the debtor in possession to collecting the legal regulated rent, with the excess between that rent and the free market rent to be escrowed awaiting the result of the state court litigation.

Under applicable state law, the Village was permitted to impose rent control where the vacancy rate as defined by the Temporary Emergency Rent Regulation

Act ("the Act") was less than 5%. The Village government may, but need not, declare that a public emergency exists in such a case and impose rent control. This the Village did on September 30, 1974. That implementing resolution was set aside by the Supreme Court of Rockland County on December 13, 1976 upon a judicial finding that the computation by the Village of the 5% threshold was defective. The Appellate Division of the Supreme Court of the State of New York for the Second Judicial Department affirmed. People ex rel. Office of Rent Administrator, Division of Housing and Community Renewal, v. Mack, 65 A.D.2d 681 (2d Dept. 1978), app. dis., 47 N.Y.2d 706 (1979). As a result of stays traditionally granted to municipalities pending appeal, the Debtor had been required to adhere to the rent restrictions imposed until the final outcome of the litigation.

On December 5, 1978 the Village adopted a new resolution based upon a vacancy rate finding as of that date, again imposing rent control for the second time. The Debtor attacked the validity and constitutionality of the 1978 resolution, and pending the final determination of that litigation was permitted to collect the free market rent, but was required to deposit in escrow with the Clerk of the County of Rockland so much of the rent collections which exceeded the controlled rent. That lawsuit and others by unrelated landlords were consolidated for trial in the Supreme Court of the State of New York, County of Rockland, and the 1978 rent control regulation was also held invalid. However, on March 14, 1984 the Appellate Division reversed. Spring Valley Gardens v. Morrero, 100 A.D.2d 93 (2d Dept. 1984). As of the date of submission of these appeals, an appeal to

the New York State Court of Appeals was pending unresolved.

During the escrow procedure all tenants were notified to submit two checks, one for the controlled rent and a second check for the difference between the controlled rent and the rent as determined by the free market. Many tenants did so, but some tenants paid the free market rent in a single check to the Debtor, which naturally deposited these checks and commingled the funds with its own moneys in apparent defiance with the escrow orders. This practice and all relevant facts were duly disclosed in the Chapter 11 proceedings in this Court.

All tenants were given due notice of the reorganization proceedings. The plan as approved by the Court allowed the tenants the opportunity to present the full amount of their claims for excess rents collected plus interest. The

Bankruptcy Court initially set June 8, 1985 as the last date to file claims, and it is the position of the Debtor that the tenants, having been given due notice and being aware of their obligation to file claims and also having been given due notice of the Bar Date, may recover in the reorganization proceedings only to the extent that their claims have been presented timely, and have been or shall be allowed by the bankruptcy Court.

The tenants' claims, referred to as class 5 claims under the Amended Plan of Reorganization, are allowed in full together with interest. However, these tenant claims are contingently allowed because there is still the possibility that the Court of Appeals might reverse the Marrero case. With other alternative provisions not directly relevant, it may be seen that tenants of Berry, if the New York State Court of Appeals affirms the

Marrero decision will receive their claims in full to the extent that they filed prior to the Bar Date, and that their rights are unimpaired by the confirmed Plan of Reorganization.

As might be expected some of the tenants did not file claims prior to the Bar Date established by order of the Bankruptcy Court dated April 27, 1984, namely June 15, 1984. On the last possible date the state through the Comptroller filed Claim No. 200 in the total amount of $405,651.46 including interest for all potential claims by tenants who failed to file timely proof of claims of their own. This claim was objected to by the Debtor on many grounds, the most significant of which is that the tenants who failed to file timely proof of claims on their own behalf would like any other general creditor of a debtor in reorganization be barred by the Bar Date and that funds

unclaimed by proper party claimants should revert to the debtor pursuant to Section 347 of the Code. The state comptroller asserts that he will be the eventual custodian of these funds after the escrow funds, and those funds which should have escrowed but were not, are deemed abandoned property under the New York Abandoned Property Law, and as such the Comptroller now has a debtor-creditor relationship with Berry.

The Bankruptcy Court held initially that the Comptroller would be considered a creditor only for the purpose of granting further protection to tenants who failed to make a timely proof of claim prior to the Bar Date previously imposed, and granted to the Comptroller the additional time until June 15, 1986 to locate those tenants and to the extent necessary assist them in filing claims. The Court also held that the Debtor should deposit the excess

rents underlying the state's claim with the office of the United States Trustee and any funds not actually claimed by tenants by the June 15, 1986 extended deadline would revert to the debtor pursuant to Section 347(b) of the Bankruptcy Code. Both the debtor and the state comptroller have appealed from portions of this decision and order.

Separately, the bankruptcy judge commenced to adjudicate the claims of tenants that were objected to by the Debtor. For reasons which are not particularly clear to this Court, Berry apparently filed a number of objections against tenant claimants who actually filed proofs of claim on their own behalf. Many of these tenants have left the area, or are unrepresented and incapable of supporting their claims, and to protect their interests the State Comptroller submitted an answer to the objections. Berry moved to

strike the answer submitted by the state on the ground that the state was not and is not an interested party in the objections to claims. It also objected to the Attorney General appearing as the attorney for the State Comptroller on behalf of tenant claimants. By order dated December 26, 1985 the Bankruptcy Court ordered that the state, or the New York State Division of Housing and Community Renewal be permitted to submit answers and appear in support of its answers in the objections to claims proceedings.

While the Debtor in its appeal presents a number of questions which it says are before this Court, the only essential questions on Berry's appeal are: (1) whether the Bankruptcy Court erred in allowed the State Comptroller to file a standby claim for tenants who paid over-charges, many of whom are not

apparently available to act for themselves; (2) whether the Bankruptcy Court erred when it extended to June 15, 198 the Bar Date for which tenant claimants may submit their own proofs of claim whic will adopt the Comptroller's claim Numbe 200 filed in their behalf, and (3) whethe the Bankruptcy Court abused its discretio in permitting the state to appear i support of the position of the tenants i objection to claim proceedings.

The State Comptroller as an appellan asserts that Section 8(11) of the Stat Finance Law gives the Comptroller th power and right to enforce any orde requiring a deposit of funds into stat court or the office of the County Court and if the money so deposited, in thi case the rent escrow, or not claimed b anyone after five years, these funds wil be transferred to the Comptroller a abandoned property and held in perpetuity

for the benefit of the true owners, pursuant to Article VI of the Abandoned Property Law of New York, the New York statutory substitute for common law escheat. Essentially, such abandoned property is seldom recovered in any significant amount, and those for whose benefit abandoned property is held are in essence only general creditors of the state.

This Court finds no abuse of discretion on the part of the Bankruptcy Court in extending the Bar Date, or in allowing the Attorney General of New York to represent the interests of claimants who have filed their own claims, or who will, by the June 15, 1986 extended Bar Date, adopt so much of Claim 200 as pertains to their own overpayments. A Bar Date is a necessary part of any reorganization or liquidation, in order that there may be certainty, and to allow a

reorganized debtor to emerge free from undetermined claims. In setting, and in enlarging, a Bar Date, the Bankruptcy Court applies general principles of equity, to achieve finality in its administration of the plan of reorganization. It is not the intent of a Bar Date to invoke an unfair or unnecessary forefeiture, nor is it intended that the Bar Date enrich a debtor unjustly. Some of the individual rent overcharge claims are comparatively modest. For much of the time it appeared likely that the claims would have no value. It seems that the apartments were used by a comparatively transient population. Many tenants failed to leave an adequate forwarding address and it is implicit in the situation that the Debtor did not go out of its way to seek and preserve permanent addresses for those who moved out while the rent control litigation was pending. Under the

circumstances, there is no reason for the Court not to permit the State of New York to appear for and represent this large group of similarly situated tenants and former tenants who have made timely filings.

The Debtor objects that it is not always possible to ascertain what "hat" the Attorney General is wearing, or put differently, to be sure whether he is acting as attorney for the State Comptroller, or as attorney for the New York State Division of Housing and Community Renewal, or in his own right as some sort of ombudsman, or as counsel to private claimants who should be required to obtain their own attorneys at their own expense. While this does present a puzzling question, it is apparent that at least until now the Attorney General would have been in the proceeding anyway in support of the theories he presents here as an appellant.

So long as the Bankruptcy Court is satisfied that his participation in connection with the disputed tenants' claims is not disruptive and serves the interests of justice, this Court finds no error and does not feel called upon to resolve whether his activities have been in whole or in part ultra vires, (essentially a question of state law) or otherwise opine on his chapeaux.

For the foregoing reasons, so much of the orders of the Bankruptcy Judge which are appealed from the Debtor, Berry Estates, Inc., are affirmed.

We turn now to the appeals prosecuted by the Attorney General of New York in behalf of the Comptroller, or however intended to be presented. As did the Bankruptcy Court, this Court rejects the rather fantastic notion that the State of New York or its Comptroller, pursuant to the New York Abandoned Property Law, can

claim, or collect, funds due to absent creditors of a Debtor in Reorganization under the Federal Bankruptcy Code, which would otherwise become in effect part of the Debtor's Estate simply because debtors failed to file a timely proof of claim. The Bankruptcy Code is a complete legislative scheme of Congress, national in scope, in an area of law preempted by the United States Constitution. The concept that the Court should establish a Bar Claim date, and that funds due creditors who do not perfect their claims in a timely manner should become the property of the Debtor in Reorganization, or the other creditors, is so significant a part of the legislative scheme as to be immune from alteration or distortion at the behest of state officials seeking to enforce state laws affecting escheat or the custody of abandoned property. See 11 U.S.C. §347(b); In re Thompson's Estate,

192 F.2d 451 (3rd Cir. 1951); Corn Exchange Bank & Trust Co. v. Empire Trust Co., 206 F.2d 30 (2d Cir. 1953). Furthermore, the State Comptroller, considered in his own capacity as acting under the New York Abandoned Property Law, or as an auditor and supervisor of the financial affairs of the Clerk of Rockland County, who is also Clerk of the Supreme Court of the State of New York in Rockland County, is not a creditor of Berry. At most he is a statutory custodian, in perpetuity, for the choses in action or funds of the tenants, who are the true creditors. Cf. In re Alan Wood Steel Co., 5 B.R. 620 (E.D.Pa. 1980); Illinois Bell Telephone Co. v. Slattery, 102 F.2d 58 (7th Cir. 1939); New York Abandoned Property Law §102.

Similarly, an escrowee, except insofar as concerns his own claims for fees and disbursements, is not a creditor,

he is at most a custodian with limited fiduciary duties. The County Clerk is therefore not a creditor of Berry.

So much of the Claim 200 filed by the comptroller which does not comprise claims also actually filed by the true creditors, the tenants, by the extended Bar Claim date, should be expunged. Insofar as appealed from by the State Comptroller, the orders of the Bankruptcy Court are affirmed. The stay of proceedings in the Bankruptcy Court granted by this Court by its decision of March 31, 1986 is vacated. Each party shall bear its own costs.

So Ordered.

Dated: White Plains, New York
April 24, 1986

s/Charles L. Brieant

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
- - - - - - - - - - - - - - - - -x

In re

Case No.
83 B 20284

BERRY ESTATES, INC.,

Debtor.

- - - - - - - - - - - - - - - - -x

DECISION ON CLAIM OF THE COMPTROLLER OF THE STATE OF NEW YORK

The State of New York, Division of Housing and Community Renewal (the "State") has moved for an order allowing its claim in the amount of $324,446.67, plus interest as a valid claim against the debtor's estate. The debtor has countered by objecting to the State's claim on the ground that there is no authority to support the claim because the State is not a creditor and that only tenants and former tenants of the debtor may properly assert any claim to the funds in question. The dispute involves funds collected by the debtor as a landlord from its tenants allegedly in excess of the legal regulated

rent under the Emergency Tenant Protection Act of 1974. As a result of a lawsuit commenced by the State, the funds were ordered by the New York Supreme Court, Appellate Division, to be deposited by the debtor with the County Clerk of Rockland County, New York. In the event that the funds in question were ultimately found to be "excess rents" they will be paid to the tenants and former tenants from the escrow account.

The debtor contends that it need not comply with the Appellate Division's order, dated December 7, 1982, which directed the debtor to pay the Rockland County Clerk the amounts collected in excess of the legal regulated rent because any such excess rents should be claimed by the tenants and not the State. Additionally, the debtor contends that the distribution of the funds is determined under bankruptcy law so that any unclaimed

funds would revert to the debtor and not escheat to the State.

FACTS

The basic facts are not in dispute. The debtor, Berry Estates, Inc., filed with this court a voluntary petition under Chapter 11 of the Bankruptcy Code on June 1, 1983. The debtor's sixth amended Chapter 11 plan was eventually confirmed by an order of this court dated October 24, 1984. The debtor is the owner of a 287 unit garden apartment complex in Spring Valley, New York, which is subject to the New York Emergency Tenant Protection Act of 1974, as amended (the "ETPA"). Pursuant to Section 3(a) of ETPA, where the vacancy rate for a town or village is less than five percent, such local government may declare that a public emergency exists and impose rent controls on the local landlords.

In September of 1974, the Village of Spring Valley adopted a resolution implementing rent controls pursuant to the ETPA. The state courts thereafter ruled that the Village's computation with respect to the five percent vacancy rate was defective. In December of 1978, the Village adopted another resolution, again establishing rent controls in accordance with the ETPA. The debtor contested the adoption of the 1978 resolution. On March 19, 1984, the Appellate Division of the New York Supreme Court for the Second Department held that the 1978 resolution was valid. Numerous state court actions involving various phases of the dispute between the debtor and the State were commenced with respect to the debtor's right to collect from its tenants rent in excess of the ETPA guidelines. The debtor also requested injunctive relief in the United States District Court, Southern

District of New York and a declaration that Section 6 of the ETPA violates the due process and equal protection clauses of the United States Constitution. On March 2, 1983, District Judge Haight dismissed the debtor's complaint on the ground that the extensive history of state litigation related to the dispute between the debtor and the State militated in favor of abstention, especially because of the existence of a pending state proceeding in which the debtor was fully able to raise the constitutional challenge to the statute.

During the course of the litigation between the debtor and the State, the latter moved for an accounting by the debtor in the Appellate Division, Second Department, requiring the debtor to state the legal regulated rent for each tenant and to return all improperly retained "excess rents" to the tenants. On

December 7, 1982, the Appellate Division granted the State's motion and:

> ORDERED that the motion is hereby granted.
>
> Appellants are directed to submit to respondents a monthly listing from October 1978 to the present of each subject apartment covered by those orders, the names of the tenants in possession, the length of the lease term, the presently collectible rent, the legal regulated rent, the differential between the legal regulated rent and the presently collectible rent. Appellants are further directed to pay the Rockland County Clerk all sums collected in excess of the legal regulated rent not previously placed in escrow as required by the Appellate Division orders or to return same to the tenants.

The Appellate Division's escrow order was patterned after an earlier Appellate Division order in March of 1980 in consolidated actions involving the New York State Division of Housing and Community Renewal and various landlords, including the debtor. 74 A.D.2d 871, 426 N.Y.S.2d 47 (2nd Dep't 1980). The pertinent language provided:

> Order modified, on the law, by deleting the second decretal paragraph thereof and substituting therefor a provision granting the preliminary injunction to the following extent only: each of the defendants is directed to deposit with the Clerk of the Supreme Court, Rockland County, any rents collected in excess of the applicable legal regulated rents herein, to be held in escrow by said Clerk during the pendency of the injunction action; in the event that the defendants prevail in the injunction action, said Clerk shall pay the funds held in escrow to the defendants; in the event that the plaintiff prevails, the funds held in escrow shall be returned to the tenants from whom they were collected, in such manner as shall be prescribed by Special Term in the final judgment. In the event that the defendants shall fail to deposit any such excess rents into court as directed herein, and upon the plaintiff's application to Special Term, a full preliminary injunction against the collection of rents in excess of the legal regulated limit shall issue. As so modified, order affirmed, without costs or disbursements.

On June 1, 1983, when the debtor filed its Chapter 11 petition with this court, it became a debtor in possession pursuant to 11 U.S.C. §1107 and was authorized to operate it business pursuant

to 11 U.S.C. §1108. A previously appointed receiver in a state court mortgage foreclosure action was required to discontinue the administration of the debtor's property and was directed to return control to the debtor pursuant to 11 U.S.C. §543. The debtor obtained a temporary restraining order from this court which permitted the debtor to charge its tenants the amount of rent that the State court allowed the receiver to collect on June 23, 1983. The state commenced a motion to modify the temporary restraining order so as to limit the debtors to collecting the legal regulated rent in accordance with the ETPA and to comply with the accounting required by the Appellate Division on December 7, 1982. By order dated August 19, 1983, this court modified the June 1, 1983 order to the extent that the debtor was permitted to

collect only the legal regulated rent from its tenants.

By order dated April 27, 1984, this court fixed June 15, 1984 as the bar date pursuant to Bankruptcy Rule 3003(c)(3), for the filing of proofs of claim against this estate. On June 15, 1984, the State filed its proof of claim for the excess rents collected by the debtor but not deposited with the County Clerk of Rockland County, as required by various state court orders, including the December 7, 1982 order of the Appellate Division, Second Department. The State's proof of claim is for the amounts allegedly over-charged those tenants of the debtor who failed to file a proof of claim. The debtor contends that the excess rents attributable to the tenants and former tenants who did not file timely proofs of claim should revert to the debtor.

DISCUSSION

Underlying the debtor's position is the contention that its tenants and former tenants, who are the persons to be protected under the various state court escrow orders, including the December 7, 1982 escrow order of the New York Supreme Court, Appellate Division, Second Department, are fully protected under the debtor's confirmed plan of reorganization. Thus, the tenants and former tenants should be entitled to receive one hundred cents on the dollar, plus interest on their allowed claims if the ETPA excessive rent controversy is finally resolved in the State's favor. Accordingly, the debtor maintains that the State's duties to protect the funds to be deposited by the debtor in escrow with the Rockland County Clerk were preempted by the filing of the Chapter 11 petition and, therefore, the State's enforcement powers were superseded by the distribution provisions

under the Bankruptcy Code. Continuing with this position, the debtor reasons that those tenants and former tenants who failed to file a claim by June 15, 1984, which was the last day fixed by the court's bar order pursuant to Bankruptcy Rule 3003, are now precluded from pursuing their claims with respect to any excess rent funds, with the result that any such unclaimed funds revert back to the debtor pursuant to 11 U.S.C. §347(b).[1]

The State asserts that the debtor should not be allowed to profit from its own wrongdoing and keep the excess rents collected in violation of the state court escrow orders by using the Bankruptcy Code as a sword so as to be able to do what no other landlord in Spring Valley is able to do, simply because the debtor filed a Chapter 11 petition.

The debtor contends that the constitutionality of the ETPA law must

await a final determination by the New York Court of Appeals. The State argues that there is no appeal as to this issue pending in the New York Court of Appeals. If the debtor is correct and its position as to the invalidity of the ETPA requirements is ultimately sustained, the excess rents which the Appellate Division ordered the debtor to deposit in escrow with the Rockland County Clerk will be returned to the debtor. Conversely, if the State is correct and the debtor's liability for excess rents is established with finality, the debtor's tenants and former tenants will be entitled to the escrow funds. Nevertheless, the debtor would like to keep any excess rents not claimed by its tenants or former tenants who failed to file timely proofs of claim in this Chapter 11 case. Whether or not the debtor may retain the unclaimed excess rent if it does not succeed in reversing

the Appellate Division's ruling in favor of the constitutionality of the ETPA law hinges upon the status of the State's claim in this case.

Had the State not filed a timely proof of claim it could not assert any interest in the unclaimed excess rent funds on the theory that such unclaimed funds escheat to the State. Corn Exchange Bank Trust Co. v. Empire Trust Co., 206 F.2d 30, 33 (2d Cir. 1953); In re Thompson's Estate, 192 F.2d 451, 453 (3rd Cir. 1951); In re Alan Wood Steel Co., 5 B.R. 620, 622 (Bkrtcy. E.D.Pa. 1980). Absent a timely proof of claim, any undistributed funds would revert to the debtor pursuant to 11 U.S.C. §347(b). Accordingly, the basic issue in this case is whether or not the State may file a proof of claim on behalf of the debtor's tenants and former tenants who have not

filed their own proofs of claim for the excess rents.

The State's right to file a proof of claim requires a determination that it is a creditor as defined in 11 U.S.C. §101(9)(A):

> (9) "creditor" means -
> (A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.

The term entity is defined in 11 U.S.C. §101(14) to include a governmental unit. Therefore, consideration must be given to whether the New York State Division of Housing and Community Renewal, which is a governmental unit, has a claim against the debtor. Pursuant to 11 U.S.C. §101(4) a claim means:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to

> payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

In Ohio v. Kovacs, 469 U.S. ____, 105 S.Ct. 705, 83 L.Ed.2d 649, (1985), a debtor's obligation under an injunction obtained by the State of Ohio requiring the debtor, as an executive officer of a corporation, to clean up a hazardous waste site was held to be a liability on a claim subject to discharge under the Bankruptcy Code. The Supreme court concluded that Ohio's right to performance under the state court injunction constituted a claim as defined in 11 U.S.C. §101(4) notwithstanding that the right to performance did not arise from a contractual arrangement. The Supreme Court pointed out that the cleanup order had been converted into an obligation to pay money, which obligation was dischargeable in bankruptcy. Similarly, in Nathanson v. NLRB, 344 U.S. 25, 73

S.Ct. 80, 97 L.Ed. 23 (1952), which involved the more restrictive term "debt" under §63(a)(4) of the now repealed Bankruptcy Act, the Supreme Court held that the National Labor Relations Board was a creditor as respects a back pay award in favor of the debtor's employees, stating:

> We think the Board is a creditor as respects the back pay awards, within the meaning of the Bankruptcy Act. The Board is the public agent chosen by Congress to enforce the National Labor Relations Act. A back pay order is a reparation order designed to vindicate the public policy of the statute by making the employees whole for losses suffered on account of an unfair labor practice. Congress has made the Board the only party entitled to enforce the Act. A back pay order is a command to pay an amount owed the Board as agent for the injured employees. The Board is therefore a claimant in the amount of the back pay.

344 U.S. at 27, 73 S.Ct. at 82 (footnote and citations omitted). A pilots' association was regarded as holding a right to payment under a collective bargaining agreement so as to qualify as a

member of an unsecured creditors' committee in In re Altair Airlines, Inc., 727 F.2d 88, 90-91 (3rd Cir. 1984), notwithstanding that the unpaid wages in question were due to individual members of the association.

In the instant case, the State, through its Division of Housing and Community Renewal, is specifically authorized under state law to enforce the ETPA and to entertain complaints from tenants for overcharged rents.

> In addition to issuing the specific orders provided for by other provisions of this act, the state division of housing and community renewal shall be empowered to enforce this act and its regulations by issuing, upon notice and a reasonable opportunity for the affected party to be heard, such other orders as it may deem appropriate.

N.Y. Unconsol. Laws §8632(2) (McKinney Supp. 1984-1985). The enforcement authority also includes the right to sue to prevent landlords from collecting excessive rents.

> Violations of this act or of the regulations and orders issued pursuant thereto may be enjoined by the supreme court upon proceedings commenced by the state division of housing and community renewal or the tenant or tenants who allege they have been overcharged. The division shall not be required to post bond.

N.Y. Unconsol. Laws §8632(5) (McKinney Supp. 1984-1985). Thus, unlike the situation in In re Cannon, 741 F.2d 1139 (8th Cir. 1984), which the debtor cites in support of the proposition that the State may not be a creditor because it was held that the Missouri Attorney General may not sue on behalf of eight specific individuals who were entitled to restitution for violations of the Merchandising Practices Act, the New York State Division of Housing and Community Renewal is empowered to commence actions in the New York Supreme Court to prevent violations of the ETPA law. Indeed, this governmental unit is the only entity authorized under state law to recover excess rents collected by

New York landlords in violation of the ETPA. As such, it is entitled to the status of a creditor, as defined in 11 U.S.C §101(9)(A), holding a claim within the meaning of 11 U.S.C. §101(4).

That the State may file a claim for the benefit of the debtor's tenants and former tenants who did not file their own proofs of claim before the bar date of June 15, 1984, does not mean that the State may keep any unclaimed excess rents as a penalty for the debtor's violation of the ETPA or that any unclaimed funds should escheat to the State. Nowhere among the provisions of ETPA is there any authority for the excess rents being paid to anyone other than to the tenants from whom the excess rents were collected. Accordingly, in order to ensure the debtor's compliance with ETPA in the context of the requirement under 11 U.S.C. §347(b) that unclaimed funds should revert

to the debtor, the debtor should deposit the excess rents required under the orders of the New York Supreme Court, Appellate Division, with the office of the United States Trustee for the Southern District of New York, to be held in an interest-bearing account. The State shall make every effort to locate and notify the debtor's tenants and former tenants that they may file individual proofs of claim in the Bankruptcy Court with respect to any excess rents to which they believe they are entitled. Such claims should be filed by tenants and former tenants no later than June 15, 1986. This period affords the State ample time to locate the tenant for whose benefit the State filed its proof of claim and to allow such tenants an opportunity to claim a refund. Any unclaimed funds remaining on hand after June 15, 1986 shall revert to the debtor pursuant to 11 U.S.C. §347(b).

In view of the fact the debtor disputes the State's calculations as to the amount of the claim for excess rents, the parties shall notify the court as to a mutually agreeable date for a hearing at which time the debtor may submit its proof in opposition to the amount claimed by the State.

CONCLUSIONS OF LAW

1. The state has a claim against the debtor within the meaning of 11 U.S.C. §101(4) and is a creditor as defined in 11 U.S.C. §101(9)(A).

2. As a creditor, the State may file a proof of claim on behalf of the debtor's tenants and former tenants who have not filed their own proofs of claim for the excess rents under the New York Emergency Tenant Protection Act of 1974, as amended.

3. The debtor should deposit the excess rents underlying the State's claim with the office of the United States

trustee for the Southern District of New York, which funds shall be held in an interest-bearing account.

4. The debtor's tenants and former tenants may file proofs of claim for the excess rents included under the State's claim by June 15, 1986, after which time, any unclaimed funds remaining on hand shall revert to the debtor pursuant to 11 U.S.C. §347(b).

A further hearing shall be held so as to afford the debtor an opportunity to contest the State's calculations as to the precise amount of the excess rents covered by its claim.

SETTLE ORDER on notice in accordance with the foregoing determination.

Dated: White Plains, New York
June 4, 1985

s/HOWARD SCHWARTZBERG
U.S.B.J.

FOOTNOTE

1. §347. Unclaimed property.

* * *

(b) Any security, money, or other property remaining unclaimed at the expiration of the time allowed in a case under chapter 9 or 11 of this title for the presentation of a security or the performance of any other act as a condition to participation in the distribution under any plan confirmed under section 943(b), 1129, or 1173 of this title, as the case may be, becomes the property of the debtor or of the entity acquiring the assets of the debtor under the plan, as the case may be.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In re

BERRY ESTATES, INC.,

Debtor.

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The Comptroller of the State of New York (the "State") having moved this Court by Notice of Motion dated March 29, 1985, for an Order allowing Claim No. 200 in the amount of THREE HUNDRED TWENTY-FOUR THOUSAND FOUR HUNDRED AND FORTY SIX DOLLARS AND SIXTY-SEVEN CENTS ($324,446.67), plus interest, as a valid claim against the estate of the debtor, Berry Estates, Inc., ("Berry") and for other and further relief;

NOW, upon the two affirmations of LAWRENCE ALEXANDER, both dated March 29, 1985, and the State's Reply Memorandum of Law in Support of Claim No. 200, dated May 23, 1985, all in support of the motion; and the Debtor having objected to said

claim, and upon the affidavits of ELIAS JOSEPHS, sworn to May 15, 1985, the affidavit of MILTON B. SHAPIRO, sworn to May 13, 1985, the affidavit of ROBERT HODESBLATT, sworn to May 14, 1985, and the affidavit of JOSPEH J. HASPEL, sworn to May 15, 1984 and the Debtor's Memorandum of Law in Support of the Objection to the State's Claim, all in opposition to the motion; and after hearing ROBERT ABRAMS, Attorney General, attorney for the State, DAVID S. COOK, Esq., and LAWRENCE ALEXANDER, ESQ., of counsel, in support thereto, and BARR AND FAERBER, attorneys for BERRY, JOSEPH J. HASPEL, of Counsel, in opposition thereto, all on May 28, 1935; and upon the written decision of the Court, dated June 4, 1985; and due notice having been given, and sufficient cause appearing therefore it is

ORDERED, that the State is a creditor as defined in 11 U.S.C.§101(9)(A), and as

such may file a proof of claim on behalf of the debtor's tenants and former tenants who have not timely filed their own proofs of claim for the excess rents as defined by the proof of claim filed and the order of the Appellate Division of the State of New York Second Department on December 7, 1982, under the New York Emergency Tenant Protection Act of 1974, as amended; and it is further

ORDERED, that upon a hearing to be held at a mutually agreeable time, a determination shall be made as to the proper amount of claim No. 200; and it is further

ORDERED, that upon the determination of the proper amount of Claim No. 200, the debtor shall deposit the determined amount with the office of the United States Trustee for the Southern District of New York, which funds shall be held in an interest-bearing account in the same

manner as funds presently held by the Trustee pursuant to the confirmed plan of reorganization; and it is further

ORDERED, that Claim No. 200 shall inure solely for the benefit of those tenants and former tenants who individually failed to timely file proofs of claims on or before the June 15, 1984 Bar Date, and that claim No. 200 shall not, in any way, inure to the benefit of the State which is a creditor and claimant only through its enforcement powers under the New York State Emergency Tenant Protection Act and functions only for the benefit of the debtor's tenants and former tenants; and it is further

ORDERED, that the debtor's tenants and former tenants who failed to file proofs of claims by the June 15, 1984 bar date shall be permitted to file proofs of claim to and including, but no later than June 15, 1986; and it is further

ORDERED, that all claims filed by tenants and former tenants subsequent to June 15, 1984, but no later than June 15, 1986, shall be placed in the same position as tenants and former tenants who filed timely proofs of claim prior to the June 15, 1984 Bare Date. Specifically, tenant and former tenant claimants filing claims subsequent to June 15, 1984, but prior to June 15, 1986, shall be considered Class V creditors under the Debtor's Sixth Amended Plan of Reorganization, and the debtor shall have all rights afforded a debtor under the Bankruptcy Code with respect to proof of claims, including but not limited to the right to object to the amount of any claim so filed; and it is further

ORDERED, that BERRY is not obligated to and the State may investigate and locate tenants and former tenants who have failed to file proofs of claims prior to

the June 15, 1984 Bar Date, at the State's own cost and expense; and it is further

ORDERED, that any and all determined but unclaimed funds held by the United States Trustee pursuant to this Order subsequent to June 15, 1986 shall immediately revert to the debtor pursuant to 11 U.S.C. §347(b).

Dated: White Plains, New York
July 3, 1985

HOWARD SCHWARTZBERG
UNITED STATES BANKRUPTCY
JUDGE

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------x

BERRY ESTATES, INC., and
BLUEBERRY HILL MANAGEMENT CORP.,

Plaintiff

-against-

STATE OF NEW YORK and DIVISION
OF HOUSING AND COMMUNITY RENEWAL
OF THE STATE OF NEW YORK,

Defendants.

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HAIGHT, District Judge:

Plaintiffs, owners and managers of an apartment complex, bring this action to challenge part of the New York State rent control statute. They request injunctive relief and a declaration that Section 6 of the Emergency Tenant Protection Act of 1974 ("ETPA") violates the due process and equal proection clauses of the United States Constitution.[1] Plaintiffs also challenge certain regulations adopted by defendant Division of Housing and Community Renewal ("Division") pursuant to the ETPA as violative of these same

constitutional provisions. The specific provisions of the ETPA challenged by plaintiffs prohibits the Division from considering costs of debt service in determing whether to grant landlords hardship rent increases. The regulation plaintiffs challenge prohibits hardship rent adjustments to landlords earning a 6% return on their original equity investment.

Plaintiffs' first mortgage on the apartment complex was obtained in December 1971 at a rate of 8-1/4% and required payment of over 2.5 million dollars of principal when the mortgage expired in December 1981. Plaintiffs allege that they attempted to refinance the property prior to the December 1981 due date, only to find that the applicable interest rate had increased to 18%. On August 11, 1982, plaintiff's application for a hardship rent increase was denied by the Division.

Plaintiffs contend that the statutory preclusion of consideration of debt service in rent adjustments has made it impossible for them to refinance their property and will result in its loss. The bank has instituted a mortgage foreclosure action against the property and a Receiver for the property has been appointed. The case is before the Court on plaintiffs' motion for summary judgment.

STATE PROCEEDINGS

The ETPA was enacted by the New York State Legislature effective May 29, 1974 and provides for regulation of residential rentals upon resolution of a local municipality that an emergency exists with respect to rental housing or a class of rental housing in the municipality. The Village of Spring Valley (the "Village") adopted, at different times, five resolutions declaring rent emergencies which invoked rent regulation under the

ETPA. The second of these resolutions, (Resolution No. 2)[2], adopted March 15, 1976, was successfully challenged by a landlord not a party to this suit. Pursuant to CPLR §5519, the Village obtained an automatic statutory stay of the order invalidating the resolution which remained in effect until May 8, 1979 when the Court of Appeals denied the Village's motion for leave to appeal. In the meantime, the Village enacted Resolution No. 4, effective January 1, 1979 which declared a housing emergency with regard to the same rentals set forth in Resolution No. 2.

The Division then learned that beginning in October, 1978, the plaintiffs herein were charging their tenants rents in excess of those fixed pursuant to Resolution No. 2 despite that Resolution's continued effect pursuant to the statutory stay and despite the applicability of

Resolution No. 4. As a consequence, on March 14, 1979 the Division notified plaintiffs, along with other landlords in the Village, that their rentals continued to be regulated by the ETPA. Plaintiffs then commenced a proceeding pursuant to CPLR Article 78 to review this notice contending, inter alia, that the ETPA as applied to them denied them full use of their property without due process and denied them equal protection. The Division then commenced an action in Supreme Court, Rockland County, to enjoin the plaintiffs from violating the ETPA.

These two actions were then consolidated for decision by stipulation. On September 7, 1979, the Supreme Court dismissed the plaintiffs' Article 78 proceeding because the Division's notice was not a final determination reviewable pursuant to Article 78. The Court declined to convert the proceeding into a

declaratory judgment action, holding that the petition did not squarely present any constitutional issues and that if such issues existed, they could be raised as defenses in opposition to a permanent injunction. After expressing its concern over the use of the statutory automatic stay provision, the Court denied plaintiffs' motion to dismiss the Division's action and granted the Division's motion for a temporary injunction against the collection of rents in excess of the regulated amounts. Matter of Berry Estates v. Marrero, 101 Misc.2d 297, 420 N.Y.S.2d 970 (1979) (Zeck,J.).

Plaintiffs appealed this decision to the Appellate Division which, on March 17, 1980, reversed the dismissal of the Article 78 proceeding, converted it into a declaratory judgment action, and modified the temporary injunction by directing the

landlords to deposit with the Clerk of the Rockland County Supreme Court any rents collected in excess of the applicable legal regulated rents, to be held in escrow for return to the party prevailing in the permanent injunction action. 74 A.D.2d 871, 426 N.Y.S.2d 47 (2d Dept. 1980).

Both actions then proceeded to trial in July 1980 in the Supreme Court. In a Judgment entered July 28, 1981, the Court, per Judge Theodore A. Kelly, dismissed plaintiffs' declaratory judgment action, granted judgment for the Division and dismissed plaintiffs' counterclaims in the action brought by the Division, permanently enjoined the plaintiffs from violating the ETPA, and ordered the Clerk to return to tenants the excess rents held in escrow.

Plaintiffs again appealed to the Appellate Division which, on September 1,

1981, continued the plaintiffs' right to collect rents above the regulated amount of the same escrow terms as the earlier order. On June 1, 1982, the Court expressly rejected plaintiffs' due process and equal protection attacks on the ETPA and unaminously affirmed the Supreme Court order dismissing plaintiffs' action. 87 A.D.2d 161, 450 N.Y.S.2d 845 (2d Dept. 1982). On July 6, 1982, the Appellate Division granted plaintiffs leave to appeal to the Court of Appeals but vacated any stay of its order of June 1, 1982 arising out of plaintiffs' motion for leave to appeal.

By order to show cause dated August 11, 1982, Judge Fuchsburg of the Court of Appeals stayed the release of the escrow funds pending consideration by the full Court of Appeals. On September 8, 1982, the full Court granted the plaintiffs' request for a stay. On December 2, 1982,

the Court of Appeals unanimously affirmed the Appellate Division decision upholding the Supreme Court's dismissal of plaintiffs' claim. Memorandum Opinion No. 669.

While plaintiffs took their appeal to the Court of Appeals, the Division returned to the lower courts to seek enforcement of the escrow order. Claiming that the plaintiffs had placed in escrow only those monies where tenants had made their check directly payable to the County Clerk, the Division moved in the Appellate Division for an accounting and return of any monies improperly retained by the plaintiffs. The Division also moved in Supreme Court, Rockland County, by order to show cause, for contempt against the plaintiffs. On December 7, 1982, the Appellate Division granted the motion for an accounting and directed the plaintiffs to pay into escrow or return to tenants

any amounts collected above the regulated rental level. On January 17, 1983, plaintiffs moved to reargue this decision. The Division's motion for contempt remains sub judice.

During the course of this litigation, plaintiffs brought separate suit in Rockland County challenging the validity of Resolutions No. 4 and No. 5. On August 2, 1982, plaintiffs obtained an ex parte stay pending their request for a preliminary injunction of the continued enforcement of the ETPA. On August 20, 1982, the stay was modified to require that collected rents above the regulated amount be placed in escrow. On December 3, 1982, the Supreme Court denied plaintiffs a preliminary injunction and vacated the temporary restraining order. The Court noted that on April 7, 1982 a receiver had been appointed for the plaintiff in the mortgage foreclosure proceeding brought

by the Jamaica Savings Bank and that it was unclear whether the plaintiffs or the receiver was entitled to collect rents from tenants. Plaintiffs have moved to renew their request for a preliminary injunction and have submitted affirmations of the receiver. This motion is also sub judice.

On November 15, 1982, the Court granted the plaintiffs' motion for summary judgment declaring Resolution No. 4 invalid on the ground of collateral estoppel based on an earlier judgment in an action brought by another landlord. The Village appealed and moved to consolidate plaintiffs' case with the pending appeal of the case which had invalidated Resolution No. 4. Plaintiffs cross-moved for an order lifting the Statutory automatic stay which the Village had received while the case was appealed. The Village and the Division opposed the lifting of

the stay, primarily on the basis of the landlord's failure to comply with prior orders of the Appellate Division in People ex rel. v. Berry Estates and the failure of the plaintiffs to join the receiver. The motion and cross-motion were submitted on January 14, 1983 and are sub judice.

In December, 1982, plaintiffs commenced a third action in Supreme Court, New York County. This suit, brought pursuant to C.P.L.R. Art. 78, seeks review of the Division's denial of a rent increase pursuant to plaintiffs' hardship application. The petition alleges that in reviewing plaintiffs' application in accordance with an operational bulletin implementing its Regulation, the Division acted in excess of its statutory authority. The Division has moved to dismiss this petition. According to the latest

advices in the record, this motion is also sub judice.

Finally, plaintiffs have commenced approximately fifteen other Article 78 proceedings in Supreme Court, Rockland County, against individual administrative decisions of the Division. The Court has either dismissed them or converted them into declaratory judgment actions. A recent motion by plaintiffs to consolidate those so converted with Berry Estates v. Village, supra, has been denied with leave to renew on proper papers.

ABSTENTION

Defendants contend that this Court should abstain from exercising jurisdiction over this case. Abstention is not a single doctrine; several distinct but related types of abstention have been articulated and applied by the courts. See Colorado River Water conservation District v. United States, 424 U.S. 800

814-816 (1975). The theory of abstention most directly applicable to this case is that which has come to be called Burford abstention. Deriving its name from the Supreme Court's decision in Burford v. Sun Oil Co., 319 U.S. 315 (1943), this theory counsels federal courts to abstain from intervening in an area of substantial state concern occupied by a specialized and complex state regulatory apparatus. See generally Colorado River Water Conservation District, supra, 424 U.S. at 814-815; Levy v. Lewis, 635 F.2d 960, 963 (2d Cir. 1980); Mathias v. Lennon, 474 F.Supp. 949, 954-955 (S.D.N.Y. 1979). Burford abstention focuses on the substantive matter at issue and both recognizes and defers to the state's overriding interest in and superior competence to adjudicate such matters. Thus, abstention under Burford does not require a lack of clarity in the pertinent state law and may

not involve a state law question at all. Arnav Industries, Inc. v. Dreskin, 551 F.Supp. 461, 464 (S.D.N.Y. 1982). See also Levy v. Lewis, supra, 635 F.2d at 964.[3]

The Court of Appeals for this Circuit ahs observed that "federal courts have abstained in numerous areas where state regulation involved matters of substantial state concern and where state policies were carried out in a statutorily established regulatory program by state officials." Levy v. Lewis, supra, 635 F.2d at 963. Of more particular relevance here, Burford abstention has been applied in this District to state and local rent control statutes in New York. See Tonwal Realties, Inc. v. Beame, 406 F.Supp 363 (S.D.N.Y. 1976).[4]

In Tonwal Realties, Inc. v. Beame, supra, a group consisting primarily of landlords challenged New York City rent

control statutes and regulations on federal constitutional grounds, both facially and as administered by municipal and state defendants. Judge Ward abstained on the basis of Burford, observing that "issues of overriding state and local concern predominate" the case. Id. at 364. The court also noted that "[t]he New York courts have not been reluctant to render decisions in rent control cases," and that a challenge to the same statutes brought by different plaintiffs was pending in the New York courts. Id. at 365. Explaining that "[i]t is in the local forum that these matters are best litigated," Judge Ward concluded that abstention "is virtually demanded in a case of this nature." Id. at 365 and 366.

Plaintiffs direct my attention to Jeter v. Kerr, 429 F.Supp. 435 (S.D.N.Y. 1977), in which Judge Lasker expressly

declined to apply Burford abstention to a federal constitutional challenge to certain aspects of the New York City Rent Control Law. There, as here, defendants placed great reliacne on the Tonwal Realties case. Judge Lasker observed that abstention was proper in Tonwal, but

> "[i]n contrast to Tonwal, plaintiffs here do not challenge substantive aspects of the Rent Control Law, such as the criteria which the law directs the City agency to consider in reaching its determination respecting [maximum Base Rent] orders."

Id. at 440. Correctly noting Burford's emphasis on "substantive aspects" of comprehensive state regulatory schemes, id. at 439, Judge Lasker concluded that "[t]he Burford lines of cases...was not meant to require a federal court to abstain from deciding a pure issue of procedural due process raised under state or local statute." Id. at 440. Judge Lasker also observed that unlike the situation in Tonwal, where there was a

pending suit in the state courts, the issues raised in Jeter had been finally addressed by the state. Id.

Applying these principals to this case, I find that abstention under the Burford doctrine is appropriate. Substantive issues of vital local concern clearly predominate this case. The ETPA expressly recognizes the localized nature of housing emergencies and charges in Housing Division with the authority to regulate and protect both the public and private interest involved in rent control. The Division exercises this authority by means of a complex regulatory apparatus and state law provides for review of administrative decision in the state courts. Plaintiffs here, as in Tonwal, challenge a substantive aspect of the state statute. Plaintiffs' complaint closely resembles the hypothetical posed by Judge Lasker in Jeter to illustrate a

situation where abstention would be proper--a challenge to the substantive criteria used to fix regulated rents. Plaintiffs expressly concede that the issue raised here has not been addressed by or even presented to the state courts. Yet, as in Tonwal, a pending state court suit exists in which the issue could be presented to and resolved by the state court.[6] Moreover, as in Tonwal, the state courts have not been reluctant to decide such issues; a fact amply evidenced by plaintiffs' own extensive litigation in the state.[7] This history of state judicial experience in the area illustrates yet another of the underlying rationales of Burford abstention: the special expertise of the state courts to adjudicate matters concerning a complex state regulatory scheme. In these circumstances, I conclude that proper respect for state governance of matters of

state concern as well as for state court adjudication of such matters warrants leaving the constitutional issue raised here for review in the first instance by the courts of New York.

The extensive history of state litigation related to this case strongly militates in favor of abstention. Perhaps most important is the existence of a pending state proceeding in which plaintiffs are fully able to raise the constitutional arguments raised here. Notwithstanding plaintiffs' arguments to the contrary, it is clear that plaintiffs' pending Article 78 proceeding in New York County does provide an available state vehicle for addressing plaintiffs' constitutional challenge to the statute. New York law provides under C.P.L.R. §103(c) that the state court may treat an Article 78 proceeding as an action for declaratory judgment on the constitutionality of a

statute and then decide the constitutional issue. See Salem Inn, Inc. v. Frank, 433 F.Supp. 183, 188 n.6 (E.D.N.Y. 1977). Plaintiffs are surely aware of this procedure since the Appellate Division expressly relied on C.P.L.R. §103(c) to convert an earlier Article 78 proceeding brought by plaintiffs into a declaratory judgment action. Berry Estates Inc, v. Marrero, 74 A.D.2d 871 (2d Dept. 1980).

It is equally clear that this pending Article 78 proceeding is a suitable vehicle for addressing plaintiffs' claims. The state proceeding arises out of the same facts which form the basis of the federal action. Plaintiffs' petition in the Article 78 proceeding is virtually identical to the complaint in this case, with the addition of and concomitant shift of emphasis to the federal constitutional challenge. The presence of the identical

state defendants in the Article 78 proceeding also ensures that once raised, opposition to the constitutional claims will be heard. See Aristocrat Health Club of Hartford, Inc., et. al. v. Chaucer, 451 F.Supp. 210, 217 (D.Conn. 1978).

Viewed together, these factors demonstrate that plaintiffs have initiated judicial proceedings in state court which provide an available and effective forum for resolving the questions raised in this federal action. By raising these questions in the pending Article 78 proceeding, plaintiffs, if successful, will be able to obtain the full remedy which they seek here--a declaration that the state statute is unconstitutional.[8] In these circumstances, abstention will not have the harsh effect of sending plaitiffs off to start all over in state court.[9]

Plaintiffs' papers candidly state that they raised their constitutional claim in federal rather than state court because of the state law provision providing the defendants with an automatic stay pending appeal of any judgment they obtain from a state court. See Tirschwll Affidavit in Opposition to Motion to Dismiss at 37 and N.Y.C.P.L.R. §5519(a). In effect, plaintiffs argue that resort to the state courts would be futile because the automatic stay would result in loss of their property during the pendency of any appeal due to the foreclousre action now pending against them. Thus, plaintiffs come to federal court to avoid the statutory stay and obtain immediate relief preventing irreparable harm.

I cannot agree that resort to the state courts would be futile. The state statute permitting the automatic stay expressly provides that "the court to

which an appeal is taken may vacate, limit or modify" the statutory stay. C.P.L.R. §5519(c). Contrary to plaintiffs' assertion, New York courts have granted this relief and vacated such stays. See, e.g., People v. Abbott Manor Nursing Home, 70 A.D.2d 434, 421 N.Y.S.2d 451, 453 (4th Dept. 1979); Turner v. Reed, 52 A.D.2d 739, 382 N.Y.S.2d 391, 393 (4th Dept. 1976); Freeman v. Lamb, 33 A.D.2d 974, 303 N.Y.S.2d 752 (4th Dept. 1970). Indeed, in People v. Berry Estates, supra, the Appellate Division rejected a claim by this same plaintiff that the Village delayed perfection of its appeal to take advantage of the statutory stay. The Court expressly advised plaintiff that it could have moved to vacate the stay pursuant to C.P.L.R. §5519(c). 450 N.Y.S.2d at 855, aff'd, Memorandum Opinion No. 669 (Dec. 2, 1982). Once again, the history of the state proceedings

demonstrates plaintiffs' familiarity with this procedure since their motion to vacate a statutory stay is sub judice in Rockland County. People ex rel. v. Berry Estates, supra.

Nor can I accept plaintiffs' suggestion that even if technically permissible vacation of the stay is practically unavailable because the state courts would refuse to grant plaintiffs' request. There is nothing in the record to support this suggestion and I most certainly will not engage in speculation that the courts of New York would deny a proper application brought pursuant to state statute. The Supreme Court has consistently rejected arguments similar to that urged by plaintiffs which are based on the suggestion that state courts will not properly uphold the law or will erroneously decide a case. In Huffman v. Pursue Ltd.,

420 U.S. 592, 611 (1974), the Court stated:

> "Appellee is in truth urging us to base a rule on the assumption that state judges will not be faithful to their constitutional responsibilities. This we refuse to do."

Here, the state courts have addressed constitutional challenges to rent control statutes in numerous cases, including those brought by these very plaintiffs. The record is simply devoid of any indication "that the New York courts are either hostile to the plaintiff or that they are deliberately ignoring or disregarding Supreme Court precedent." Anonymous v. Association of the Bar of the City of New York, 515 F.2d 427, 435 (2d Cir. 1975).

I am mindful of this Court's obligation to exercise its jurisdiction when property invoked and to enforce the provisions of the United States Constitution. I must also be concerned, however,

with the fundamental concept of comity which necessitates

> "sensitivity to the legitimate interests of both State and National Governments...in which the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the states."

Younger v. Harris, 401 U.S. 37, 44-45 (1971). I conclude that such sensitivity requires that I allow the state courts the first opportunity to decide the questions raised here where plaintiffs, challenge part of a complicated and integrated statutory scheme which regulates important local substantive interests and where plaintiffs are already before a state court which provides them with an available and effective state forum for adjudicating these issues.

CONCLUSION

For the reasons stated, I conclude that this federal action must be dismiss-

ed. The state courts are entitled to the first opportunity to address and resolve the issues plaintiffs raise here. The Supreme Court has recently observed that dismissal is not a permanent bar to federal adjudication because the federal courts "remain open to a dismissed plaintiff who later demonstrate(s) the inadequacy of the state forum." Moses H. Cone Memorial Hospital v. Mercury Construction Corporation, No. 81-1203, 51 U.S.L.W. 4156, 4163 (Feb. 23, 1983). Accordingly, the action is hereby dismissed without prejudice to renewal by plaintiffs upon a showing that the state forum is inadequate to promptly and completely resolve their claims. The Clerk of the Court is directed to dismiss the complaint without prejudice and without costs.

It is So Ordered.

Dated: New York, New York
March 2, 1983

S/ CHARLES S. HAIGHT

FOOTNOTES

1. Section 8626 of the ETPA provides in pertinent part:

"d. Provision shall be made pursuant to regulations under this act for individual adjustment of rents...where an owner by application to the state division of housing and community renewal for increases in the rents in excess of the rent adjustment authorized by the rent guidelines board under this act establishes a hardship, and the state division finds that the rate of rent adjustment is not sufficient to enable the owner to maintain approximately the same ratio between operating expenses, including taxes and labor costs but excluding debt service, financing costs, and managment fees, and gross rents which prevailed on the average over the immediate preceding five year period, or for the entire life of the building of less than five years. This subdivision shall apply to accommodations outside a city of one million or more."

2. The respective resolutions are numerically designated for the purpose of convenient reference.

3. The Burford case alleged violations of federal law and was brought under federal question jurisdiction. See Levy v. Lewis, supra, 635 F.2d at 964; Colorado River Water Conservation District v. U.S., supra, 424 U.S. 815 n.21. Burford abstention thus differs from Pullman type abstention which requires the presence of an ambiguous state law question which may either

moot or modify the federal constitutional issue. Avoidance of unnecessary determination of federal constitutional question is not a primary purpose of Burford abstention. Colorado River Water Conservation District v. U.S., supra, 424 U.S. at 814-815.

4. Judge Goettel recently applied the Burford abstention doctrine to a diversity action between a landlord and tenant arising out of a lease regulated by New York City's rent control statutes. Arnav Industries, Inc. v. Dreskin, supra, 551 F.Supp. at 461. Judge Goettel observed that state interests predominated, that the state had a comprehensive and detailed regulatory mechanism, that the expertise of the state system had already been invoked by pending administrative action, and that review of the administrative decision was available in the state courts pursuant to C.P.L.R. Article 78. In these circumstances, Judge Goettel concluded that Burford mandated abstention in order "to avoid harmful federal interference with complex state regulatory systems" resulting primarily from the risk that the federal court might reach a inconsistent with that reached by the state. Id. at 464. Unlike Tonwal or the present case, Arnav did not involve a federal constitutional question.

5. The constitutional issues raised in plaintiffs' earlier state court suits were directed at different provisions of the ETPA.
6. The pending state court suit in Tonwal

differs from that here in that the issues raised by plaintiffs here has not been raised in the state suit. Here, however, in contrast to Tonwal, the plaintiffs are parties to the state suit and could raise their constitutional questions in that forum. See discussion, infra, p. 14.

7. Over thirty years ago, Judge Augustus N. Hand observed:

"The New York courts have shown no hesitation in dealing with matters of rent control, and a resort to those courts in order to interpret the Act before us may avoid consideration of questions arising under the Constitution of the United States and possible conflicts in the views of the two courts....The state courts are the proper tribunals to construe the state rent statutes and to determine the scope of the public emergency with respect to which the New York Legislature acted. It is therefore evident that we should not consider the validity of the state Act before us."

Teeval Co., Inc. v. Dewey, 91 F.Supp. 891, 893-94 (S.D.N.Y. 1950). Plaintiffs in Teeval had claimed, inter alia, that the statute violated the Fourteenth Amendment because it allowed a return of only 2% of the net value of rented premises. Id at 893.

8. Plaintiffs also argue that abstention is not appropriate to a federal constitutional challenge to the face of an unambiguous state statute. This argument is more properly raised within the context of Pullman type

abstention. See Wisconsin v. Constantineau, 400 U.S. 433 (1971) and footnote 4, infra. The Supreme Court has more recently observed that

> "[t]he breadth of a challenge to a complex state statutory scheme has traditionally militated in favor of abstention, not against it. This is evident in a number of distinct but related lines of abstention cases which, although articulated in different ways, reflect the same sensitivity to the primacy of the state in the interpretation of its own laws and the cost of our federal system of government inherent in federal-court interpretation and subsequent invalidation of parts of an integrated statutory framework."

Moore v. Sims, 442 U.S. 415, 427 (1978).

9. The Supreme Court has also recognized that a federal court can refuse to exercise its discretion on the ground of judicial economy when there is a pending state action:

> "There are principles unrelated to considerations of proper constitutional adjudication and regard for federal-state relations which govern in situations involving contemporaneous exercise of concurrent jurisdiction, either by federal courts or by state and federal courts. These principles rest on considerations of '[w]ise judicial administration, given regard to conservation of judicial resources and comprehensive disposition of litigation.'"

Colorado River Water Conservation

District v. U.S., supra, 424 U.S. at 817, quoting Kerotest Mfg. Co. v. C-O-Two Fire Equip. Co., 324 U.S. 180, 183 (1952). See also Giulini v. Blessing, 654 F.2d 189, 193, (2d. Cir. 1981) ("federal court is not precluded, in the exercise of its discretion, from staying proceedings in the action before it pending a decision by the state courts, with a view to avoiding wasteful duplication of judicial resources and having the benefit of the state court's view"). While I do not rest my decision on this theory, which should be reserved for "exceptional" circumstances, see Moses H. Cone Memorial Hospital v. Mercury Construction Corp., No. 81-1203, 51 U.S.L.W. 4156, 4160 (Feb. 23, 1983), I note that further action in this Court would undoubtedly result in duplication of effort arising out of the overlap between the state and federal actions. As discussed in the text, this suit can be comprehensively disposed of in the state court.

No. 86-1839

Supreme Court, U.S.
FILED
JUL 14 1987
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

In re: BERRY ESTATES, INC.,

Debtor.

BERRY ESTATES, INC.,

Petitioner,

vs.

HON. EDWARD REGAN,
COMPTROLLER OF THE STATE OF NEW YORK,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND JUDICIAL CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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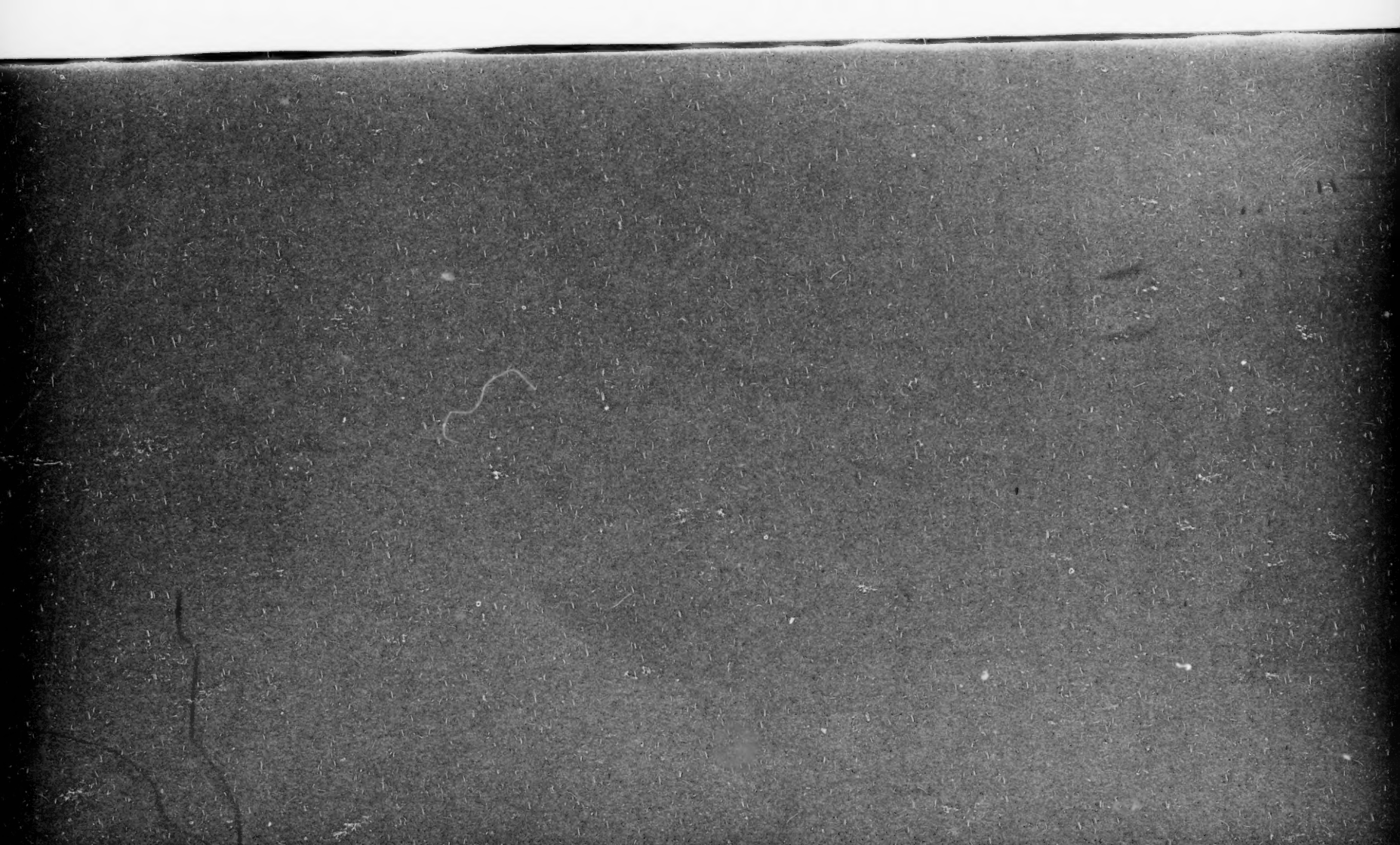

QUESTIONS PRESENTED

1. Whether the Comptroller of the State of New York, who is authorized under New York State Finance Law § 8(11) to enforce state court orders requiring the deposit into state court of money to be held in escrow is a "creditor" with a "claim" as those terms are defined by the Bankruptcy Code?

2. Whether certain orders of New York State courts under that state's Emergency Tenant Protection Act of 1974 should control disposition of unlawful excess rents collected by a landlord who thereafter filed for relief under Chapter 11 of the Bankruptcy Code?

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BRIEF FOR RESPONDENT IN OPPOSITION

ADDITIONAL STATUTES AND RULES INVOLVED

11 U.S.C. §§ 101(4), (9), 502(b) and New York State Finance Law §§ 8(11) provide:

Title 11, U.S.C. § 101

(4) "claim means –

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, disputed, undisputed, secured, or unsecured.

(9) "creditor" means –

(A) an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.

Title 11, U.S.C. § 502(b)

(b) Except as provided in subjections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that –

(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

(2) such claim is for unmatured interest;

(3) if such claim is for a tax assessed against property of the estate, such claim exceeds the value of the interest of the estate in such property;

(4) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services;

(5) such claim is for a debt that is unmatured on the date of the filing of the petition and that is excepted from discharge under section 523(a)(5) of this title;

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds –

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of –

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease without acceleration, on the earlier of such dates;

(7) if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds –

(A) the compensation provided by such contract, without acceleration, for one year following the earlier of –

(i) the date of the filing of the petition; or

(ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus

(B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates; or

(8) such claim results from a reduction, due to late payment, in the amoount of an otherwise applicable credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor.

N.Y. State Finance Law (McKinney 1986) provides:

§8. Duties of the comptroller

The comptroller shall: 1. Superintend the fiscal concerns of the state.

* * *

11. Supervise the administration of all the funds paid into any court of record or ordered to be so paid by a judgment, order or decree of any such court of record, and/or paid to the public administrator of any county and/or to the county treasurer of any county to whom letters of administration have been or shall be granted, or to any other administrator having the custody of funds payable to the state comptroller pursuant to the provisions of section two thousand two hundred twenty-two of the surrogate's court procedure act. He shall have power and authority to institute proceedings to enforce obedience to the judgments, orders or decrees of the said courts for the deposit of moneys and securities into court, and prescribe regulations and rules for the care and disposition thereof, which shall be observed by all parties interested therein, unless the court having jurisdiction over the same, shall make different directions by special order duly entered in accordance with article twenty-six of the civil practice law and rules. The comptroller may at any time require any county clerk or clerk of any court of record, to file with any county treasurer an officially certified copy of any record, document or paper, or extracts therefrom, which he may deem necessary for the use of said county treasurer in the administration of such funds . . .

Bankruptcy Rule 3003(c)(3) provides:

FILING PROOF OF CLAIM.

3) "Time for Filing. The Court shall fix and for cause shown may extend the time within which proofs of claim or interest may be filed."

STATEMENT OF THE CASE

Respondent adopts the statement of the case presented in the opinion of the Court below, 812 F.2d at 69-71, (App. 63-66) and asserts that petitioner's Statement of the Case is inaccurate in the following respects:

1. Petitioner's statement (Pet., 31) that its tenants had ample opportunity to present and protect their claims for excess rents ignores the fact that many tenants-creditors could not be found, and thus had no notice of the pendency of the bankruptcy proceedings. As the District Court below observed, "Many tenants failed to leave an adequate forwarding address, and it is implicit in the situation that the Debtor did not go out of its way to preserve permanent addresses for those who moved out while the rent control litigation was pending." (App., 84).

2. In his motion for allowance of his claim, Claim No. 200, the Comptroller argued that he was a "creditor" with a "claim" as those terms are defined in 11 U.S.C. § 101(4),(9)(A). Petitioner's statement (Pet., 33), that the Comptroller argued that he had a "debtor-creditor" relationship with petitioner is correct insofar as it goes; however, the terms "claim" and "creditor", as defined in the Bankruptcy Code, encompass a broader range of the relationships and obligations than traditional "debtor-creditor" concepts, which, generally, were based on economic relations. *See e.g. Ohio v. Kovacs*, 469 U.S. 274, 279 (1982): "There is no indication in the langauge of the statute that the right to performance cannot be a claim unless it arises from a contractual arrangement." Indeed, one of the errors assigned by the Comptroller in his appeal of the District Court's decision was the Court's failure to consider the broadened definitions of the Code. (App., 86-89).

3. Contrary to petitioner's argument (Pet., 35) that 11 U.S.C. § 347(b) applies to the monies claimed by the County Clerk, that section provides, in pertinent part, that funds held by a trustee or debtor in possession which are unclaimed at the end of the time allowed for participation in the distribution under

a confirmed plan become property of the debtor. Where a creditor has timely filed a proof of claim, as the Comptroller did here pursuant to the mandate of N.Y. State Finance Law § 8(11), his right to participate in the distribution pursuant to a plan can be defeated only by disallowance of his claim. Consequently, § 347(b) is inapposite where, as here, debtor's funds are in fact claimed.

4. Although Petitioner correctly recognizes the Comptroller as the party in interest in the litigation concerning Claim No. 200, it incorrectly states: "In its decision and order, the Bankruptcy Court held, *inter alia*, that the Comptroller would be considered a creditor . . . " (Pet., 35).

In fact, the Bankruptcy Court mistakenly stated that the creditor who had filed Claim No. 200 was the Division of Housing and Community Renewal ("the Division") 49 B.R. 1002, 1003 (Bkrptcy. S.D.N.Y. 1985) (App. 90). That Court held that, because the Division was not authorized by state statute to receive payment of the excess rents, its claim would be allowed only to the extent that the Bar Date would be extended for the purpose of finding the missing tenants, and that remaining funds would revert to the Debtor pursuant to 11 U.S.C. § 347(b), 49 B.R. at 1007 (App., 108-110). In contrast, the Court of Appeals held that the Comptroller, as statutory agent for the Rockland County Clerk who was empowered to receive payment, had a claim which was fully allowable, and it ordered the Debtor to pay the claim, 812 F.2d at 72 (App., 69).

REASONS FOR DENYING THE WRIT

Petitioner argues that its petition should be granted because the Courts below erred, and because there is a conflict among the Courts of Appeals. Both arguments are without merit.

Petitioner asserts that the decision of the Court of Appeals "carved out a new exception" to the Bankruptcy Code (Pet., 43) by permitting the State to administer a bankruptcy debtor's property outside the statutory scheme enacted in Title 11, (*id.*), contrary to Congressional intent. Further, Petitioner argues

that because only the Court of Appeals for the Second Circuit has carved out this exception, a conflict of lower courts has arisen which requires review by this Court to resolve. However, in the absence of a contrary opinion from another Circuit, there is no conflict among the Courts of Appeals.

Citing *State of Missouri v. U.S. Bankruptcy Court for the Eastern District of Arkansas*, 647 F.2d 768 (8th Cir. 1981), *cert. denied* 454 U.S. 1162 (1982); *In re Cash Currency Exchange*, 762 F.2d 542 (7th Cir. 1985), *cert. denied*, __ U.S. __, 106 S.Ct. 233 (1986); and *State of Texas v. Wellington Resources Corp.*, 406 F.2d 533 (5th Cir. 1983), petitioner contends that the funds which were the subject of the escrow orders were property of the debtor's estate, as such property is defined in Section 541 of the Bankruptcy Code, 11 U.S.C. § 541, and that the County Clerk of Rockland County was a custodian, as that term is defined in Section 101(10) of the Bankruptcy Code, 11 U.S.C. § 101(10), who was obligated to surrender the funds to the Bankruptcy Court's jurisdiction pursuant to Section 543 of the Bankruptcy Code, 11 U.S.C. § 543. Petitioner then advances the rather novel idea that because the funds are property of the estate in bankruptcy, they are somehow magically exempt from the legitimate claim of the Comptroller who timely filed a proof of claim pursuant to an explicit state statute.

Such has never been the law of bankruptcy. On the contrary, the traditional function of bankruptcy has been to collect and then distribute the debtor's property to his creditors. Assuming *arguendo* that the funds are property of the estate, by timely filing a proof of claim, then moving for its allowance (the genesis of the instant litigation), the Comptroller not only recognized the Bankruptcy Court's exclusive jurisdiction over property of the estate, but participated in the administration of that property within both the spirit and the letter of the Bankruptcy Code.[1] The Court of Appeals, contrary to Petitioner's argument,

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[1] Thus, this case is distinct from the cases cited by Petitioner, where the state authorities were attempting to supersede, through parallel proceedings, the Bankruptcy Court's administration of the estate.

did not carve out a new exception to the Bankruptcy Code, but rather held, in accordance with this Court's decision in *Ohio v. Kovacs*, 462 U.S. 274 (1985), that one way in which states can enforce police powers against debtors in bankruptcy is by filing a claim in Bankruptcy Court and having that claim allowed.

Petitioner also argues that the Comptroller was unauthorized to seek enforcement of the state court escrow orders by filing a claim. (Pet., 54-58). It contends that when creditors may enforce their own private rights against a debtor, a State official may not seek to enforce those same rights for the public's benefit, citing *In re Cannon*, 741 F.2d 1139 (8th Cir., 1984). Unlike *Canon*, the state court order sought to be enforced in this case was expressly in favor of both the individual creditor-tenants *and* the Rockland County Clerk, *see* Order of the Appellate Division of the Supreme Court of the State of New York, Second Judicial Department dated December 7, 1982.[2] Here Petitioner's liability to the private tenant-creditors and the Rockland County Clerk was joint and several; while in *Cannon*, the Missouri

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[2] Although the Court of Appeals did not quote from that order, it referred to it, 812 F.2d at 70 (App. 65): "Following the [New York] Court of Appeals' affirmance the Division moved in the Appellate Division for an accounting by Berry of all excess rents it had collected. The court granted the motion and ordered that Berry pay the Rockland County Clerk all sums collected in excess of the legal regulated rent that had not previously been placed in escrow." The full text of the Appellate Division Order is part of the Record herein. The decretal paragraph is reproduced below:

> Appellants [Berry] are directed to submit to respondents a monthly listing from October 1978 to the present of each subject apartment covered by those orders, the names of the tenants in possession, the length of the lease term, the presently collectable rent, the legal regulated rent, the differential between the legal regulated rent and the presently collectable rent. *Appellants [Berry] are further directed to pay the Rockland County Clerk all sums collected in excess of the legal regulated rent not previously placed in escrow as required by the Appellate Division orders or to return same to the tenants.* [Emphasis added].

Attorney General could not enforce a state court judgment on behalf of consumer creditors absent a judgment in *his* favor, 741 F.2d at 1142. Indeed, the Comptroller had not only the right, but the duty to enforce the Order of the Appellate Division requiring the deposit of money into court. N.Y. State Finance Law § 8(11).[3] *See, Gardner v. New Jersey*, 329 U.S. 565, 575 (1947).

Petitioner's argument that the Court below, by allowing a state to file a proof of claim for the benefit of others, circumvents the Bankruptcy Code, (Pet., 57) is unfounded. Nothing in the Bankruptcy Code precludes two or more parties with claims arising from the same transaction or right from each having a claim or being a creditor, as those terms are defined in 11 U.S.C. § 101(4), (9)(A). In addition, as this Court has recognized as long ago as 1952, the fact that a creditor claims for the benefit of another creditor is immaterial to the allowance of the claim. *Nathanson v. N.L.R.B.*, 344 U.S. 25 (1952). The position of the Comptroller here is akin to that of an indenture trustee who cannot locate all of the beneficiaries of his trust. *See In re Paramount Publix Corporation*, 72 F.2d 219 (2nd Cir. 1934) and in *In re United Cigar Stores Co.*, 68 F.2d 895 (2nd Cir. 1934) where the claim of just such an indenture trustee was allowed.[4] The Comptroller's position as a trustee is confirmed by statutes which charge him with the duty of enforcing orders requiring the deposit of money into court, N.Y. State Finance Law § 8(11), and which provide that legal title, but not equitable title to moneys so deposited vests in the County Clerk, N.Y. Civ. Prac. Law and Rules § 2601(c) (McKinney 1984).

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[3] Petitioner's reliance on *Cannon* is misplaced also, in that contrary to its unsupported statement (Pet., 55, 56), the Emergency Tenant Protection Act, N.Y. Unconsol. Laws §§ 8621-8634 (McKinney 1986) "the ETPA", as of June 1, 1983 (the date of the filing of the bankruptcy petition) did *not* provide that tenants would have a private right of action if wronged by a landlord's violation. The tenant's right of action was added to the ETPA later that month, *see* Ch. 403 McKinneys Laws of 1983, eff. June 30, 1983.

[4] *See also, Corn Exchange Bank Trust Co. v. Empire Trust Co.*, 206 F.2d 30 (2nd Cir, 1953) which is not to the contrary. There the Court reaffirmed the holding of these two cases, but on the facts before it, did not apply them.

Finally, no better answer to Petitioner's criticism (without authority) that the Court of Appeals "decision in this case allows a state *to continue* to administer a debtor's property by filing a proof of claim on behalf of others . . . " (Pet., 57) is found than the words of Chief Judge Augustus Hand in *Paramount Publix Corporation* case, *supra*:

> " . . . After the date of payment . . . [the bank as indenture trustee] shall hold or distribute it . . . like any other creditor who has received dividends, subject only to the obligations arising under its trust and the law of the state of New York, and *without supervision of the bankruptcy court.*" (Emphasis added.)

72 F.2d at 222-223. Once a claim is paid to a creditor it leaves the jurisdiction of the bankruptcy court—in no way a circumvention of Title 11, as Petitioner claims (Pet., 57), but a fulfillment of the Bankruptcy Code's purpose.

Petitioner confuses matters by emphasizing the discussion in the opinion of the Court of Appeals of the police and regulatory powers of the State, 812 F.2d at 71 (App., 67, 68). Petitioner does not challenge the Court's discussion of the proper balance to be struck between the state's police powers and the authority of the Bankruptcy Court, 812 F.2d at 71 (App., 68), but argues that the Court of Appeals "recast" the escrow order of the State court "into a penalty" (Pet., 42). Petitioner further argues that that erroneous characterization led the Court below into the additional error of holding that the escrow order could be enforced by the Comptroller under the exception to the Section 362(a) stay (provided by Section 362(b)(4), (5) and the cases of this Court cited by Petitioner (Pet., 39, 40) applying the statutory exception) because it was a penalty.

Petitioner correctly points out (Pet., 41) that neither of the parties view the escrow order as punitive. It erroneously concludes that the enforcement of a non-punitive order by filing a proof of claim would have been barred by the Section 362(a) stay. The issue in this case is not the applicability of the Section 362(a) stay, but whether or not the Comptroller's claim

was properly allowed by the Court of Appeals. Petitioner advances no reason for disallowance under 11 U.S.C. § 502(b) and did not do so in the Courts below. The applicability of Section 362(a) is irrelevant to the issue; nothing in that section precludes a creditor from merely filing a proof of claim in the Bankruptcy Court and seeking to have the claim allowed, as the Comptroller did here. The discussion by the Court of Appeals of the Section 362(a) stay and the Section 362(b) exceptions to it are *dicta*, for as the Court correctly noted, "The State Court actions were brought by Berry and were not subject to an automatic stay, [citation omitted] or an ordered stay." 812 F.2d at 71 (App., 67).

Petitioner advances no other reasons for granting a writ of certiorari.[5] Because the Court below correctly allowed the Comptroller's claim, and no inter-circuit conflict exists, the petition should be denied.

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[5] Although Petitioner presents the Bankruptcy Court's *sua sponte* extension of the Bar Date as a question raised by this Petition, (Pet., 4) it is not addressed in its argument. The issue of the Bankruptcy Court's discretion in this matter was correctly decided by the Court of Appeals, 812 F.2d at 71, (App. 68, 69). *See* Bankruptcy Rule 3003 (c)(3), 11 U.S.C.A. (1984).

CONCLUSION

For the reasons stated above the petition for a writ of certiorari should be denied.

Dated: New York, New York
July 13, 1987

Respectfully submitted,

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REPLY

BRIEF

Supreme Court, U.S.
FILED
AUG 3 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1839

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

In re: BERRY ESTATES, INC.,

Debtor.

BERRY ESTATES, INC.,

Petitioner,

vs.

HON. EDWARD REGAN,
COMPTROLLER OF THE STATE OF NEW YORK,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND JUDICIAL CIRCUIT

REPLY BRIEF OF PETITIONER

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Additional Statutes Needed To Reply

11 U.S.C. §§ 101(10), 101(27) and 101(28) provide:

11 U.S.C. §101. Definitions

In this title --

(10) "custodian" means -

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;

(B) assignee under a general assignment for the benefit of the debtor's creditors; or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors;

(27) "indenture" means mortgage, deed of trust, or indenture, under which there is outstanding a security, other than a voting trust certificate, constituting a claim against the debtor, a claim secured by a lien on any of the debtor's property, or an equity security of the debtor;

(28) "indenture trustee" means trustee under an indenture;

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1986

BERRY ESTATES, INC., Petitioner,

v.

HON. EDWARD REGAN, COMPTROLLER OF THE STATE OF NEW YORK,

REPLY BRIEF IN FURTHER SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND JUDICIAL CIRCUIT

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Berry Estates, Inc., the petitioner herein, submits this Reply Brief in further support of its petition requesting that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Judicial Circuit entered in the above-entitled case on February 19, 1987.

REPLY TO RESPONDENT'S "QUESTIONS PRESENTED"

The first question presented by the Respondent asks:

> Whether the Comptroller of the State of New York, who is authorized under New York State Finance Law §

> 8(11) to enforce state court orders requiring the deposit into state court of money to be held in escrow is a "creditor" with a "claim" as those terms are defined by the Bankruptcy Code? (emphasis added)

This "question presented" ingeniously contemplates only one-half of the true issue at bar - specifically, the simple question of whether an escrow agent may file a claim on behalf of escrow beneficiaries when the debtor did not escrow monies prior to the filing for relief under the Bankruptcy Code. It is respectfully submitted that to complete this "question," so that it accurately presents the issue at bar, one must ask the follow up question: If an escrow agent may file a claim on behalf of the escrow beneficiaries, may the escrow agent keep the escrow fund when the escrow beneficiaries (the true claimants) do not timely file a proof of claim, although ordered to do so, or should these unclaimed funds revert back to the debtor under the clear dictates of 11 U.S.C. §347(b).

Both ends of this question are, to date,

unanswered by this Court and of critical importance to further administration of Bankruptcy cases. This is because until the Second Circuit's decision in this case, it has been apparently accepted law that, under 11 U.S.C §543(b), a custodian (i.e. an escrow agent) of property of the debtor (as defined by 11 U.S.C. §541) must turn over the property of the debtor so that it could be administered through the bankruptcy proceeding.[1] The Second Circuit's decision below would permit custodians to step into the shoes of the true claimants, file a claim on behalf of creditors who were duly notified to file their own proofs of claim, but did not do so, and thereafter allow the custodian to keep the monies unclaimed by the true claimants in derogation of 11 U.S.C §347(b) which clearly provides for the disposition of unclaimed property. It is respectfully submitted

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1. In the instant case, the property was not escrowed prior to the filing of the Petition for bankruptcy relief. Thus, no turnover proceeding was required.

that Congress did not enact 11 U.S.C. §§541 (defining "Property of the Estate"), 543 (defining a custodian and his powers and duties) and 347 so that these sections could be, so easily, circumvented. It would be absurd to believe that Congress would separate the notion of custodian from that of creditor, then require a custodian to turn over property of the estate to the trustee (or debtor in possession as the case may be) to be administered through the bankruptcy proceedings, and, at the same time, allow the custodian to reclaim the property of the estate so that he could control it himself.

The second question presented by the Respondent is also a question which should be addressed by this Court. Yet again, Respondent, misleadingly, only presents one-half of the entire issue at bar. The question reads:

> Whether certain orders of New York State courts under that state's Emergency Tenant Protection Act of 1974 should control disposition of

unlawful excess rents collected by a landlord who thereafter filed for relief under Chapter 11 of the Bankruptcy Code?

The reason the language of this question is misleading is that it suggests that there is a dispute regarding the power of the New York State judiciary to enforce New York Law. In fact, there is no dispute. Of course, the State of New York's judiciary has the power to enforce the laws of the State of New York. This is precisely what occurred in the instant case. During the pendency of the Chapter 11 proceeding, New York State's Division of Housing and Community Renewal ("DHCR") and the Debtor litigated the New York State issues in New York State Courts. Specifically, the central issue of the validity of rent regulation in the Village of Spring Valley, New York was ultimately decided on June 5, 1986 by the New York's Court of Appeals (Spring Valley Gardens Associates v. Marrero, 68 N.Y.2d 627, 505 N.Y.S. 2d 57 (1986)). Moreover, the amount of rent

overcharges for each tenant were determined by administrative proceedings at DHCR. Thus, the state issues, which represent the foundation of the tenants' claims against the debtor, were all adjudicated in New York State courts. The only issues remaining are the pecuniary claims themselves, and whether these claims, which are unclaimed by the true owners, must revert back to the debtor as prescribed by 11 U.S.C §347(b), or whether they may escheat to the state.

REPLY TO RESPONDENT'S STATEMENT OF THE CASE

In Paragraph 1 of his "Statement of the Case", Respondent falsely implies that the Debtor did not adequately notice the true claimants. (Respondent's Brief p. 5) However, Respondent does not cite anything whatsoever which would indicate that the Debtor did not fulfill its notice requirements. This is because Respondent could not do so. In fact, the record in this case will reflect that the Debtor made more of an effort to notify potential claimants

than it was required to do. Yet, it is true that "many tenants-creditors could not be found" (Respondent's Brief p.5). The Court should be aware that the Record of this case will indicate that not only did the debtor make extra efforts to locate claimants through publishing public notices, but DHCR was actively involved in protecting and locating "unknown" tenants, as well as counsel to the tenants' association at the Debtor's apartment complex. All of these parties actively searched for the tenants who disappeared. Thus, the statement of the case, as enunciated by Respondent, brings the true controversy into focus. Specifically, whether 11 U.S.C. §347(b) should be declared ineffective, as the Second Circuit determined, so as to allow a custodian to have greater rights to unclaimed property of the estate than the debtor itself.

Paragraph 2 of Respondent's Statement of the Case deals exclusively with the

legal definitions of "creditor", and "claim". Respondent's assertions of "fact" are not "fact" but legal issues and conclusions which can only be presented on appeal. In Paragraph two, Respondent goes so far as to cite legal authority (Ohio v. Kovacs, 469 U.S. 274, 279 (1982)) to support its statement of fact. Although it would be more appropriate to argue this issue at the time the legal issues are briefed, Respondent's raising of this issue compels a response. Suffice it is to say at this point that Ohio v. Kovacs, supra, was not concerned with a purely pecuniary claim like we have at bar, but whether an obligation under a state court injunction is subject to a discharge in bankruptcy. While it is true that this Court broadly read the definition of "claim" and "creditor" within the context of determining whether an obligation was dischargeable, it is respectfully submitted that the Ohio v. Kovacs case ought not be read so broadly as to grant a custodian the ability to be a

creditor and claim unclaimed property as its own.

Paragraph 3 of the Respondent's Statement of the Case is also more appropriately a legal conclusion than a statement of the case. Respondent asserts that because it, as an undisputed custodian, made a claim, 11 U.S.C. §347(b) ought not be applicable. This statement boldly assumes that the central issue at bar is determined in Respondent's favor. It is interesting to note that the Second Circuit, at best, glanced over this crucial issue, and, at worst, simply disregarded the controlling statutes.

In the Respondent's fourth point within its Statement of the Case, Respondent calls to the Court's attention that the Bankruptcy Court "mistakenly" confused two arms of the executive branch of the government of the State of New York, specifically, the Comptroller of the State of New York and DHCR. One must note that only the DHCR is empowered by the laws of the State of New

York to protect tenants' rights, and accordingly, DHCR intervened in the bankruptcy case to preserve tenants' interests. As stated above, DHCR made efforts to locate the tenants who had disappeared, and DHCR commenced administrative procedures to fix the amounts of the tenants' claims. The Bankruptcy Court recognized the separate functions of the Comptroller and the DHCR. The Comptroller is the overseer of the escrow agent (the Clerk of Rockland County, New York) and DHCR is the protector of tenants (or landlords) within the framework of New York's rent regulation statutes. It was obvious that the Bankruptcy Court was making its best effort, within the structure of the Bankruptcy Code, to protect the interests of tenants who had failed to file timely proofs of claims. After all, prior to the Second Circuit's decision below, it was accepted law that a custodian must turn over property it held to be administered through the bankruptcy proceedings (11 U.S.C. §543), and, conversely, a custodian

could not reclaim property of the estate which was unclaimed by the true creditors and obtain a windfall by adding the funds to its own treasury. Indeed, the Debtor agrees that the Bankruptcy Court erred in recasting the Comptroller's claim as a Claim of the DHCR, and this error has been part of the Debtor's appellate arguments and would naturally be addressed in full in the appeal brief should this petition be granted. The Debtor's position is that under the Bankruptcy Code, it is inappropriate for a custodian to make a claim on behalf of true claimants who, after proper notice, failed to perfect their interests by filing a timely proof of claim.

REPLY TO RESPONDENT'S "REASONS FOR DENYING THE WRIT"[2]

In his "Reasons for denying the Writ",

2. As in his Statement of the Case, Respondent's "Reasons for denying the Writ" is replete with legal arguments which go to the merits of this case. As these arguments are addressed, Petitioner is compelled to respond and will do so in a cursory manner. It should be noted that Petitioner has refrained, as much as possible, from presenting legal arguments as this would be more appropriate in the Appellant's brief.

the Respondent discounts the conflict among the Circuits cited in the initial petition by hollowly asserting "there is no conflict among the Courts of Appeals." To further his spurious argument, the Respondent misleads the Court by asserting, as if there were no controversy, that Respondent has a "legitimate claim." Of course, if Respondent had a "legitimate claim" which gave him pecuniary rights independent of the true claimants, then, maybe, Respondent's argument that it has simply followed the letter of the law would have merit.[3]

Although there is a controversy over the

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3. Throughout this case, Petitioner has argued that Respondent's claim is akin to a class claim made by the State of New York on behalf of the true claimants who failed to file a timely proof of claim. In this vein, the Court is respectfully directed to a recent case in the Tenth Circuit entitled In re Standard Metals Corp., 817 F.2d 625 (10th Cir. 1987) which held that a class proof of claim is impermissible in bankruptcy cases and cannot be used to evade the statutes and rules which require that proofs of claim be individually filed by the true claimants. There are many similarities between the Standard Metals Corp. case and this case which will be brought out in an appeal brief.

legitimacy of Respondent's claim, there is no controversy regarding the fact that the Respondent's claim relates to his power to enforce escrow orders of the State courts. Moreover, there is no controversy regarding the fact that the Respondent would have no claim if the escrow beneficiaries did not have a valid claim. And, there is no controversy regarding the fact that the Respondent's claim is an effort to enforce its police powers as defined by §8(11) of the New York State Finance Law. The issue here is what a state may do when its actions, in the name of "police power", collide with the principles of the Bankruptcy Code. In contrast to the Eighth Circuit[4], the Seventh Circuit[5], the Fifth Circuit[6], the Sixth

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4. State of Missouri v. U.S. Bankruptcy Court for the E. D. of Arkansas, 647 F.2d 768 (8th Cir. 1981), cert. denied 454 U.S. 1162, 102 S.Ct. 1035, 71 L.Ed.2d 318 (1982), In re Cannon, 741 F.2d 1139 (8th Cir. 1984) and Equal Employment Opportunity Commission v. Rath Packing Company, 787 F.2d 318 (8th Cir. 1986).

5. Cash Currency Exchange, Inc., 762 F.2d

(footnotes continued on next page.)

Circuit[7], and the First Circuit[8] which all held that only non-pecuniary issues of the states may continue to be pursued by the states after a debtor has filed for relief under the Bankruptcy Code, the Second Circuit's decision would allow a state to enforce an entirely pecuniary matter relating to claims of third parties outside the jurisdiction of the Bankruptcy Court. Cf. Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. ___, 107 S.Ct. 755, 88 L.Ed. 859 (1986), Kelly v. Robinson, 479 U.S. __, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986) and Ohio v. Kovacs, 469 U.S. 274, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985).

(footnotes continued from last page)

542 (7th Cir 1985), cert. denied, 106 S.Ct. 233 (1986).

6. State of Texas v. Wellington Resources Corp., 706 F.2d 533 (5th Cir. 1983).

7. In re Mansfield Tire & Rubber Co., 660 F.2d 1108 (6th Cir. 1981).

8. Cournoyer v. Town of Lincoln, 790 F.2d 971 (1st Cir. 1986).

The balance of the Respondent's Brief in Opposition contains legal argument which address the merits. As stated above, Petitioner believes that the legal questions presented ought to be fully briefed at the time of appeal. Nevertheless, as Respondent has raised these arguments, Petitioner is once again compelled to respond.

The facts in In re Cannon, 741 F.2d 1139 (8th Cir. 1984) are squarely on point with the case at bar. The issue presented was the power of a state to enforce pecuniary rights of its citizens in a bankruptcy case. The statute involved in the Cannon case is functionally equivalent to the statutes to protect tenants in the instant case. The fact that an escrow order existed in the instant case is immaterial because under 11 U.S.C. §543, if the funds ordered to be escrowed were being held in escrow, these funds would have had to be turned over to the trustee (debtor in possession) to be administered in the

bankruptcy case. It is elementary bankruptcy law that state court escrow orders are superseded by the Bankruptcy Code's administrative functions. The assertion by Respondent that the Debtor's liability to the true creditors and the custodian was "joint and several" ignores 11 U.S.C. §543 and the uncontradicted fact that the Respondent is seeking to claim escrow monies which the true claimants failed to claim. Of course, as the true claimants can not be located, under the decision of the Second Circuit, the custodian will be permitted to keep this money. In other words, funds unclaimed by the true claimants will revert into the treasury of the State of New York as a penalty to the debtor.

Further arguing on the merits, the Respondent takes the position that his status is akin to an indenture trustee and he proceeds to cite cases which state that an indenture trustee may make a claim on behalf of the indenture beneficiaries and thereafter hold the proceeds of the claim

for the indenture beneficiaries. This specious argument is without merit for a number of reasons. First, and most obvious, the Respondent herein is not an indenture trustee as defined by the Bankruptcy Code (see 11 U.S.C. §§101(27) and 101(28). On the other hand, he falls squarely within the Bankruptcy Code's definition of "custodian" (see 11 U.S.C. §101(10). Secondly, the Bankruptcy Code specifically provides that an indenture trustee may file a proof of claim. On the other hand, the Bankruptcy Code does not provide that a custodian may file a proof of claim (see 11 U.S.C. §§501(a) and 543). Thirdly, the law cited by Respondent contemplates the Bankruptcy Act of 1898, which has been repealed, not the controlling Bankruptcy Code of 1978. "Section 543 [of the Bankruptcy Code which defines the rights and duties of custodians] makes important substantive changes in prior law." 4 Collier on Bankruptcy ¶543.01 (15th Ed.).

Finally, Respondent takes exception to Petitioner's argument that the Second Circuit wrongly recast the escrow requirement into a penalty so as to allow it to reach its conclusion. In his obfuscated argument that the Second Circuit did not recast the escrow requirement into a penalty, the Respondent reaffirms that neither of the parties herein view the escrow order as punitive. In that light, the Respondent argues that the Second Circuit's discussion of the automatic stay (11 U.S.C. §362) is inconsequential. Petitioner agrees with Respondent that the Second Circuit's usage of 11 U.S.C. §362 was misdirected. Petitioner agrees that the escrow orders were not punitive. However, these assertions by Respondent do not change the fact that the Second Circuit recast the escrow orders as a penalty and based its conclusion upon that recharacterization. The Second Circuit, quoting Matter of Plaza Realty Investors and Queens

Blvd. Properties Co. v. New York City Conciliation and Appeals Board, 111 A.D.2d 395 (1985), plainly stated:

> Converting the refund to the prior tenants into a fine should the prior tenants not claim the refund guaranteed that petitioner [the landlord] would not benefit from its misconduct.
>
> Id. at 397. See also N.Y. Penal Law §180.55 which makes rent gouging a misdemeanor.

812 F.2d at 69.

With a certainty, the Second Circuit unfairly considered the Debtor a wrongdoer and based its decision upon that determination. However, it is important that the Court note: (1) that there has never been a criminal proceeding; (2) that the validity of rent regulation in the Village of Spring Valley, New York was not finally determined until June 5, 1986, which was both after this objection to claim proceeding was heard by the Bankruptcy Court and after the initial appeal to the District Court was determined; (3) that the Chapter 11 Plan of Reorganization provided that should the New

York Courts ultimately uphold the validity of rent regulation in the Village of Spring Valley, then all tenant claimants who filed proofs of claim would receive 100% of their allowed claim plus interest; and (4) the true claimants who properly filed claims have been paid. With this background, it is respectfully submitted that the Second Circuit's recharacterization of Respondent's claim presents a gross injustice to the Debtor.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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